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No. _____

In The

Supreme Court of the United States

BENJAMIN J. CAYETANO and EARL I. ANZAI,

Petitioners,

v.

CHEVRON USA, INC.,

Respondent.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Ninth Circuit

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. Does the Takings Clause authorize a court to invalidate state rent control or land use regulatory legislation on its face, without regard to whether it diminishes economic value or use or causes any physical invasion of the plaintiff's property, when the court concludes that the statute does not substantially advance a legislative purpose?

2. Does the facial constitutional validity of state legislation depend on whether a federal court predicts that it will achieve its objective?

PARTIES TO THE PROCEEDINGS

The parties to the proceedings below were petitioners Benjamin J. Cayetano, the Governor of Hawaii, and Earl I. Anzai, the Attorney General of Hawaii, and respondent Chevron USA, Inc. Earl I. Anzai was substituted below for his predecessor as Attorney General, Margery S. Bronster, pursuant to Fed. R. App. P. 43(c)(2).

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OPINIONS BELOW

The opinion of the Court of Appeals for the Ninth Circuit is reported at 224 F.3d 1030, and is reprinted in the appendix hereto, App. 1, *below*. The opinion of the District Court granting respondent's motion for summary judgment is reported at 57 F. Supp. 2d 1003 (D. Haw. 1998) and is reprinted at App. 43.

JURISDICTION

The Ninth Circuit entered its judgment and opinion on September 13, 2000. Petitioner filed timely petitions for reconsideration and for reconsideration *en banc* on September 27, 2000. The Ninth Circuit denied these petitions on October 26, 2000 and entered an amended order on October 31, 2000. App. 69-72.

The jurisdiction of this Court to review the decision of the Ninth Circuit is invoked under 28 U.S.C. § 1254(1).

CONSTITUTIONAL PROVISIONS AND STATUTE INVOLVED

The Fifth Amendment to the Constitution provides in relevant part: "No person shall be . . . deprived of life, liberty, or property, without due process of law; nor shall private property be taken for public use, without just compensation." The Fourteenth Amendment provides, in section 1: "[N]or shall any State deprive any person of life, liberty, or property, without due process of law; nor

deny to any person within its jurisdiction the equal protection of the laws."

The relevant portion of Act 257, Haw. Rev. Stat. § 486H-10.4 (1997), is reprinted at App. 73.

STATEMENT OF THE CASE

Hawaii enacted Act 257 in 1997 to try to temper the State's relatively high retail price of gasoline. Haw. Rev. Stat. § 486H-10.4. The Act limits the amount of rent that oil distributors may charge gasoline retailers who lease company-owned filling stations to 15% of gross profit from gasoline sales and of gross revenue from sale of other products. Chevron owns 64 stations in Hawaii, which it leases to operators who sell Chevron gasoline at retail.

Chevron filed suit in the United States District Court for the District of Hawaii against the Governor and Attorney General of Hawaii, claiming that Act 257 facially effects an unconstitutional regulatory taking and seeking declaratory relief. Chevron moved for summary judgment, advancing several arguments. The District Court granted Chevron's motion, holding that the act constituted a regulatory taking because it failed to substantially advance a legitimate government interest.

The District Court found that the station rent control law was intended to be and was logically related to the legitimate purpose of reducing retail gasoline prices. App. 55-56. But the Court understood itself to be bound by the precedents of the Ninth Circuit and of this Court

to apply a higher standard of scrutiny, captured in the phrase "substantially advance" a legitimate government interest. The Court reasoned that since the Act did not regulate the sale of a station lease by an operator, the lessee could capture a "premium" in the sale price, reflecting the difference between the regulated and market rents, and thus could defeat the goal of holding down gasoline prices. The Court also concluded, somewhat inconsistently, that there would be no savings (and no premium), because Chevron could recover lost rent by raising the price it charged the operator for gasoline. The District Court expressly rejected the State's argument that the proper standard of review was whether the legislature reasonably could have believed that the statute would hold down retail gasoline prices. App. 52-54.

On appeal, the Ninth Circuit held that the District Court had applied the correct standard but vacated the grant of summary judgment and remanded for trial. The Court of Appeals, too, rejected the State's argument that the validity of a land use ordinance should be evaluated under the traditional standard of the due process clause, "whether 'the Legislature rationally could have believed the Act would substantially advance a legitimate government purpose.' " App. 6. The Court felt itself bound by circuit precedent, *Richardson v. City and County of Honolulu*, 124 F.3d 1150 (9th Cir. 1997), *cert. denied*, 525 U.S. 871 (1998). The Court interpreted "substantially advance" to "depend[ ] on whether it will in fact lead to lower fuel prices." App. 24-25. Finding that the affidavits relied on by the trial court did not clearly resolve this question, the Court of Appeals remanded for a trial. It recognized that the inquiry would deal with "questions of predictive fact,

rather than historical fact." App. 18. The Court expressly found that the legislation does not deprive Chevron's property of economic viability, noting that the legislation allows it to charge "more than it would otherwise have charged under its own rental program." App. 25.

Judge William Fletcher concurred in the result but disagreed with the majority's analysis. App. 28. Within the constraints of circuit precedent, he argued that the court should have applied the more lenient due process standard of reasonableness previously applied to rent and price control legislation. App. 28, 37. He concluded:

> I fear that under the majority opinion virtually all rent control laws in the Ninth Circuit are now subject to the "substantially advances a legitimate state interest" test, and that this test may invalidate many of these laws. . . . The question before the judiciary is not the advisability of rent control laws but rather their constitutionality. Ever since its retreat from economic substantive due process at the end of the 1930s, the Supreme Court has essentially left it to the other branches of government to decide . . . whether to adopt rent and price controls." App. 40-41.

REASONS FOR GRANTING THE WRIT

I. The Ninth Circuit's Rule That the Validity of Property Regulation be Analyzed Under the Takings Clause Raises an Important Issue Which This Court has Recognized as Unsettled and Conflicts with Decisions by State Supreme Courts and by the Court of Federal Claims.

Claims that legislation takes property from an owner, by authorizing a permanent physical invasion or by destroying its economic viability, properly invoke the Takings Clause. By contrast, claims that state legislation falls outside the police power, because it fails to rationally relate to a legitimate state purpose, long have been considered under the Due Process Clause. Since 1996, however, the Ninth Circuit has insisted that challenges to the rationality and validity of land use regulation not only may but must be analyzed under the Takings Clause, rather than under the Due Process Clause.[1] Moreover, the Ninth Circuit has made it clear that it will apply a higher

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[1] *Armendariz v. Penman*, 75 F.3d 1311 (9th Cir. 1996) (en banc). Indeed, the Ninth Circuit interpreted this Court's decision in *Graham v. Connor*, 490 U.S. 386 (1989), to mean that the "constitutional bar on 'private takings' preempts [more generalized] substantive due process claim[s]." *Armendariz*, 75 F.3d at 1322. Thus, challenges to the validity of land use ordinances may be brought only under the Takings Clause. Other circuits have rejected this view, *e.g.*, *John Corp. v. City of Houston*, 214 F.3d 573, 583 (5th Cir. 2000), and it has been severely criticized. *See* Toni Massaro, *Reviving Hugo Black? The Court's "Jot For Jot" Account of Substantive Due Process*, 73 N.Y.U. L. Rev. 1086, 1100-03 (1998). This collateral issue would disappear if this Court held, as it should, that challenges to the reasonableness of legislation may not be brought under the Takings Clause.

standard of scrutiny when it reviews state legislation under the Takings Clause than it would under the Due Process Clause, although it has never presented any principled justification for this much greater intrusion into State democratic decision making. Such error and confusion concerning core constitutional provisions require prompt cure by this Court.

In this case, the court below held that Hawaii's Act 257 must be found to violate the Takings Clause if the trial court finds that it will not "substantially advance" the state's legitimate purpose of reducing the retail price of gasoline. The Ninth Circuit's decision clearly commits that court to use of the Takings Clause for second guessing the wisdom of virtually all state and local legislation regulating land, bringing doctrinal confusion in this area to an appalling level and endangering the relationship between federal courts and state governments. This Court needs to resolve this confusion and restore the appropriate and traditional deference that federal courts show state legislation addressing social and economic problems.

This Court has not authoritatively resolved whether challenges to the means – ends rationality of legislation may be resolved under the Takings Clause. Indeed, contradictory indications by the Court may have fostered the confusion that now reigns in the lower courts, making timely guidance from this Court particularly appropriate. Of course, this Court authored the long line of cases establishing that arbitrary legislation violates due process. *E.g., Village of Euclid v. Ambler Realty Co.*, 272 U.S. 365, 395 (1926). The confusion stems from *Agins v. City of Tiburon*, 447 U.S. 255, 260 (1980), where the Court, while

unanimously upholding a large lot zoning ordinance against a facial challenge, stated that a taking occurs where the law "does not substantially advance legitimate state interests." For that proposition, the *Agins* opinion, issued near the end of the 1979 Term, cites only a due process decision, *Nectow v. City of Cambridge*, 277 U.S. 183, 188 (1928). Although the Court has quoted *Agins* subsequently, it neither has explained its meaning nor ever struck down a regulation as a taking for failing this test. It is high time the Court clarify that the *Agins* formulation amounts only to inadvertent *dicta*.

The Court has given several indications that it is ready to do so. Indeed, in *Eastern Enterprises v. Apfel*, 524 U.S. 498 (1998), even though the Court struck down retroactive health care liability legislation, five justices stated that questions about the legitimacy of economic legislation should be addressed under the Due Process, rather than under the Takings Clause. *Id.* at 545-6 (Kennedy, J., concurring); *id.* at 554 (Breyer, J., dissenting). Justice Kennedy explicitly noted the "uneasy tension" between his view and the *Agins* test. *Id.* at 545. He concluded: "Given that the constitutionality of the Coal Act appears to turn on the legitimacy of the Congress' judgment rather than on the availability of compensation . . . the more appropriate constitutional analysis arises under general due process principles rather than under the Takings Clause." *Id.* Justice Breyer, for four dissenters, wrote, "As this language [of the Takings Clause] suggests, at the heart of the Clause lies a concern, not with preventing arbitrary or unfair government action, but with providing *compensation* for legitimate government action that takes 'private property' to serve the 'public' good." *Id.* at 554 (emphasis

in original). Even if these congruent conclusions from five justices do not technically constitute a holding with which the Ninth Circuit is in conflict, it does indicate that a majority of the Court rejects the linchpin of the decision below.

The Court also raised but expressly did not settle the appropriateness of the "substantially advance" test for a takings challenge in *City of Monterey v. Del Monte Dunes of Monterey, Ltd.*, 526 U.S. 687, 704 (1999). In *Del Monte Dunes*, the Court affirmed liability based on an instruction permitting the jury to decide whether denial of a permit related to a legislative interest, without deciding whether the Takings Clause authorized such an instruction, because the defendant had explicitly agreed to the instruction. In this case, by contrast, defendants contested the standard for review in both the Court of Appeals and the District Court. App. 6, 52. In addition to the Court, the authors of the separate opinions went out of their ways to "express no view," *Del Monte Dunes* at 732 n.2 (Scalia, J., concurring in part and concurring in the judgment), and "offer no opinion," *id.* at 753 n.12 (Souter, J., concurring in part and dissenting in part), about whether the *Agins* test was correct. Plainly, the justices view this question as open and timely.

Del Monte Dunes also made clear the important analytical distinction between exaction cases and regulation cases. The Court has required that transfers of physical possession or ownership from a private owner to the government in exchange for approval of a development plan, referred to generally as exactions, both "substantially advance" and be "roughly proportional" to the goals of the relevant legislation. *Dolan v. City of Tigard*,

512 U.S. 374 (1994); *Nollan v. California Coastal Commission*, 483 U.S. 825 (1987). But these cases address the discreet and sensitive question of when a permit condition can effect an actual physical occupation without resulting in a taking and have no logical bearing on when a regulation becomes so burdensome as to effect a taking. The Court confirmed in *City of Monterey v. Del Monte Dunes at Monterey, Ltd.*, 526 U.S. 687, 702-03 (1999), that the rough proportionality test of *Dolan* had been fashioned for exactions and had no role in assessing regulations of use. The same logic requires the conclusion that the substantially advance test of *Nollan* has no role in reviewing a regulation. Without the transfer of physical possession there is neither need nor justification for a higher level of scrutiny of the state's reason for its action. Thus, in another useful way, the Court recently has shed light on the error below.

In sum, all nine justices recently have authored or joined opinions admitting the need for clarification of this important issue. Thus, the Court has identified and framed the question here cleanly presented, making this an unusually compelling case for the grant of certiorari.

The Ninth Circuit's approach directly conflicts with decisions by the Rhode Island and Washington Supreme Courts squarely holding that challenges to the rationality of land use regulation must be brought under the Due Process, not the Takings Clause. *Brunelle v. Town of South Kingston*, 700 A.2d 1075, 1083-84 n.5 (R.I. 1997) ("[T]he arbitrariness or capriciousness of a particular state action is properly examined under the light of the Fourteenth Amendment due process clause and not the Fifth Amendment takings clause."); *Mission Springs Inc. v. City of*

Spokane, 954 P.2d 250, 258 (Wash. 1998). No doubt more courts would be in conflict with the decision if they did not feel bound by the Court's pronouncement in *Agins*.

The Ninth Circuit rule also squarely conflicts with a long line of decisions by the United States Court of Federal Claims, which has jurisdiction over all takings claims for just compensation against the United States under the Tucker Act. That Court has consistently held that challenges as to whether legislation "substantially advances" a government interest cannot be entertained under the Takings Clause and fall outside that court's jurisdiction. *Bamber v. United States*, 45 Fed. Cl. 162, 165 (1999); *Florida Rock Industries, Inc. v. United States*, 45 Fed. Cl. 21, 42 (1999); *Loveladies Harbor v. United States*, 15 Cl. Ct. 381, 390 (1988), *aff'd*, 28 F.3d 1171 (Fed. Cir. 1994) ("[N]o court has ever found a taking has occurred solely because a state interest was not legitimately advanced . . . "). The Claims Court's refusal to hear challenges to the validity of federal legislation may reflect its sensitivity to limitations on the liability of the United States under the Tucker Act.

The confusion below extends beyond these direct conflicts as lower courts have struggled to make sense of the Court's inconclusive statements. In *Santa Monica Beach, Ltd. v. Superior Court*, 968 P.2d 993 (Cal. 1999), where the California Supreme Court upheld a rent control ordinance against a facial takings challenge, Justice Kennard explicitly requested this Court to resolve the confusion sown by *Agins*:

> [R]ecently, Justice Kennedy of the United States Supreme Court has questioned the appropriateness of using a means ends test as the measure

> of whether a taking has occurred. . . . Outside the *Nollan/Dolan* context, should a means-ends test be used to determine whether a taking has occurred, or instead should means end testing remain within due process jurisprudence? Only the high court can resolve this question and, given the importance of this area of law, I respectfully suggest that it do so when the opportunity next arises.

Id. at 1012-13 (Kennard, J., concurring).[2] *See also John Corp v. City of Houston*, 214 F.3d 573, 579 n.9 (5th Cir. 2000) (avoiding "knotty issue" of whether claim that government action failed to advance a public purpose should be brought under Due Process or Takings Clause). Commentators have argued for years that it is anomalous to test the validity of legislation under the Takings Clause. John Echeverria, *Takings and Errors*, 51 Ala. L. Rev. 1047 (2000); Jerold Kayden, *Land Use, Regulations, Rationality, and Judicial Review: The RSVP in the* Nollan *Invitation*, 23 Urb. Law. 301 (1991).

The Ninth Circuit's insistence on testing the rationality of state legislation under the Takings Clause plunges litigants into a host of logical and practical problems. Certainly, the most harmful effect has been the heightened level of scrutiny applied to economic legislation just because land is the asset being regulated. The

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[2] Justice Brown, who dissented, echoed the plea of Justice Kennard: "If such measures [*i.e.*, rent control ordinances] are capable of withstanding a *Nollan*-inspired takings clause analysis, the high court ought to tell us so, probably sooner rather than later." *Santa Monica Beach, Ltd., supra*, 968 P.2d at 1047.

difference in standard between regulation of land and of other contractual or property assets seems particularly indefensible in this case, where Chevron both leases land and sells gasoline to the retailer. Hawaii's regulation of rent is subject to demanding review under the Takings Clause, but a regulation of wholesale gasoline prices would be considered under the more generous standard of the Due Process Clause. *See, e.g., Permian Basin Area Rate Cases*, 390 U.S. 747, 769-70 (1968). No reasoned justification for decreasing dramatically the scope of legislative discretion to regulate commercial real estate as opposed to other business assets has ever been offered. We address this issue at length below under the heading of the next argument.

The Due Process Clause serves as a substantive limit on governmental power; laws found in violation generally are held invalid. The Takings Clause, by contrast, "is designed not to limit governmental interference with property rights *per se*, but rather to secure *compensation* in the event of otherwise proper interference amounting to a taking." *First English Evangelical Lutheran Church v. County of Los Angeles*, 482 U.S. 304, 315 (1987) (emphasis in original). Legislation challenged as invalid may impose quite minor burdens on a property owner, as the Ninth Circuit found was the case here, App. 25, which in no way resemble the severe losses targeted by the Takings Clause. Arbitrary legislation does not raise the fundamental question of whether it forces "some people alone to bear public burdens which, in all fairness and justice should be borne by the public as a whole." *Armstrong v. United States*, 364 U.S. 40, 49 (1960). Arbitrary legislation imposes burdens that no one should bear.

Entertaining challenges to the validity of legislation under the Takings Clause raises perplexing questions about remedy. The constitutionally required remedy for a regulatory taking is an award of just compensation. *First English, supra,* 482 U.S. 314-22. But it is difficult to understand what constitutes "just compensation" when the fault of the law is that it does not achieve its objectives, since this fault bears no economic relationship to the property owner's loss, if any.

Respondents here sued seeking declaratory relief. But this Court has repeatedly held that "[e]quitable relief is not available to enjoin an alleged taking of private property for public use, duly authorized by law, when a suit for compensation can be brought against the sovereign subsequent to the taking." *Ruckelshaus v. Monsanto Co.,* 467 U.S. 986, 1016 (1984); *see also Presault v. ICC,* 494 U.S. 1, 11-17 (1990). The plurality in *Eastern Enterprises, supra,* strove to fashion an exception to this rule when the payment of compensation by government would be nonsensical, as it would be here, 524 U.S. at 519-22, but the need to improvise such an exception and its uncertain scope suggest the continuing problems of jamming square pegs in round holes. Similarly, some courts have limited plaintiffs' "temporary takings" damages, after a statute has been held invalid under the Takings Clause, to damages based on "actual losses," the measure that would have been used if the case had been brought under the Due Process Clause, rather than "compensation for the period during which the taking was effective." *First English, supra,* 482 U.S. at 321. *See, e.g., Corrigan v. City of*

Scottsdale, 720 P.2d 513, 518-19 (Ariz. 1986). Paying compensation often would confer windfalls on owners.[3] Moreover, because the public, by definition, does not benefit from arbitrary legislation, the fairness argument for compensation by taxpayers fails.[4]

The issue presented here is among the most important that the Court can resolve at this time. The Ninth Circuit's rule subjects virtually all state and local government regulation touching land in the western third of the United States to illogical and unjustifiably intense judicial

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[3] In *Tampa-Hillsborough County Expressway Authority v. A.G.W.S. Corp.*, 640 So.2d 54 (Fla. 1994), the Florida Supreme Court initially had held that the state highway department's authority to mark the location of future roads on an official map constituted a taking because it did not advance a legitimate state interest. After trial courts began to permit affected property owners jury trials on compensation for temporary takings, with no preliminary showing of any economic injury, the Court changed the doctrinal basis for its invalidation to the Due Process Clause to limit indemnification to those who actually suffered damage.

[4] The Ninth Circuit also has felt compelled to create an exception from the finality rules of *Williamson County Regional Planning Comm'n v. Hamilton Bank of Johnson City*, 473 U.S. 172 (1985) for regulatory takings claims brought under the "substantially advance" rubric. Because such claims do not depend on how much economic value is left in the plaintiff's property or the extent to which it has been compensated, but on the effectiveness of the legislation, they are considered immediately ripe. *Richardson v. City and County of Honolulu*, 123 F.3d 1150, 1165 (9th Cir. 1997), *cert. denied*, 525 U.S. 871 (1998). This exception further demonstrates the illogic of addressing issues of validity under a constitutional provision concerned with compensation for what the government takes away for valid reasons.

second-guessing, fomenting extensive, expensive litigation under a fundamentally incoherent constitutional doctrine. This Court should take responsibility for clearing up this dangerous confusion, having recognized that *Agins* is problematic and is creating havoc in the lower courts. This Court can save all lower courts from troublesome confusion and wasted effort by now making it clear that challenges to the means ends rationality of legislation should be brought under the Due Process and not the Takings Clause.

II. The Ninth Circuit Adopted a Standard of Review That Requires Courts to Evaluate the Wisdom of State Legislation Contrary to Fundamental Constitutional Principles and in Conflict with the Decisions of Other Federal Courts of Appeal and State Supreme Courts.

Whether challenges to the validity of state land use regulation are adjudicated under the Due Process Clause, as we urge, or under the Takings Clause, the standard of review is crucial to maintaining a proper balance between democratic governance and the rule of law. Since at least the 1930's, this Court generally has employed a rational relationship test for Due Process and Equal Protection Clause challenges to social and economic legislation. Under this test, the Court upholds legislation that a rational legislator could have believed would advance a permissible public purpose. *E.g., Williamson v. Lee Optical*, 348 U.S. 483, 487-88 (1955). The Court has exercised "strict scrutiny" in cases where legislation touches upon certain "fundamental interests," so that the legislation will be held invalid unless the state can show that it is

necessary to advance a compelling state interest. *E.g., Moore v. City of East Cleveland*, 431 U.S. 494, 499-500 (1977) (occupancy statute struck down for burdening interests of members of extended family in living together). Some few cases may fall in an intermediate category, where the interests affected are unusually important but not fundamental and where a tighter fit between means and ends must be demonstrated than in rational basis cases. *See e.g., City of Cleburne v. Cleburne Living Center*, 473 U.S. 432 (1985). Although the Court has divided over how to determine which interests require a higher level of scrutiny, this basic structure has been remarkably consistent.

Land use regulation has long been considered social and economic regulation subject to rational basis scrutiny. *Village of Belle Terre v. Boraas*, 416 U.S. 1, 8 (1974); *Village of Euclid v. Ambler Realty Co.*, 272 U.S. 365, 395 (1926). And the validity of rent control laws, when not confiscatory, has been subject to invalidation only when "arbitrary, discriminatory, or demonstrably irrelevant to the policy the legislature is free to adopt." *Pennell v. City of San Jose*, 485 U.S. 1, 11 (1988). Experts dispute whether or under what conditions rent control laws are efficacious. But the wisdom of this long line of cases is that the usefulness of a rent control or other land use laws is a question that should be decided by the people through their elected representatives and not by judges.

In this case, the Ninth Circuit held that Act 257 must "substantially advance" the public interest, that legislation "substantially advances" an interest if it "bears a reasonable relationship" to that interest, and that "[w]hether Act 257's rent cap is reasonably related to its objective of lowering fuel prices certainly depends on

whether it will in fact lead to lower fuel prices." op at 14. This standard affords the decision of the Hawaii legislature no deference at all. It instructs the trial judge to void the statute if, based upon testimony concerning "predictive facts," a telling oxymoron, he predicts that the Act will not work. This Court should not permit lower federal courts to exercise such supervisory power over the merits of state legislative decisions. Such a judicial role resembles far too closely that prevalent during the discredited *Lochner* era, when courts struck down maximum hour legislation because they did not think that it would protect the health of workers or minimum wage legislation because they did not think it would improve the economic position of workers. *Lochner v. New York*, 198 U.S. 45 (1905); *Adkins v. Children's Hospital*, 261 U.S. 525 (1923).

The court below should have instructed the trial court to uphold Act 257 only if there is no possibility that it can achieve a lawful objective. "[W]hether *in fact* the provision will accomplish its objectives is not the question: the [constitutional requirement] is satisfied if . . . the . . . [state] Legislature *rationally could have believed* that the [Act] would promote its objective." *Hawaii Housing Authority v. Midkiff*, 467 U.S. 229, 242 (1984) *quoting Western & Southern Life Ins. Co. v. State Bd. of Equalization*, 451 U.S. 648, 671-72 (1981) (emphasis in original).[5] It is bedrock constitutional law, that "[e]ven if

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[5] The Ninth Circuit argues that *Midkiff* is irrelevant, because a lower standard of rationality is appropriate in a case involving expropriation and payment of compensation. *Richardson v. City and County of Honolulu*, 124 F.3d 1150, 1158 (9th Cir. 1997), *cert. denied*, 525 U.S. 871 (1998). This argument is weak. First, it ignores that the *Midkiff* Court expressly equated

the wisdom of the policy be regarded as debatable and its effects uncertain, still the legislature is entitled to its judgment." *West Coast Hotel Co. v. Parish*, 300 U.S. 379 (1937). In this case, the district court held that providing a flexible maximum rent logically aimed at reducing gasoline prices (App. 55-6), but did not substantially advance that goal, making clear that the court used a raised standard. Both the District Court and Ninth Circuit explicitly rejected Hawaii's argument that the lower, traditional level of scrutiny should be used. App. 6-7, 52-54. But this Court long ago stated the correct view:

> "Whether the enactment is wise or unwise, whether it is based on sound economic theory, whether it is the best means to achieve the desired result, whether, in short, the legislative discretion within its prescribed limits should be exercised in a particular manner, are matters for the judgment of the legislature, and the earnest conflict of serious opinion does not suffice to bring them within the range of judicial cognizance." *Chicago, B. & Q. R. Co. v. McGuire*, 219 U.S. 549, 569 (1911).

Federal court scrutiny of state social and economic legislation at this level of intrusiveness, not only violates

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the scope of the legislature's discretion under the eminent domain power with that under the police power, 467 U.S. at 240. Second, the argument illogically advocates a higher level of scrutiny for the validity of legislation having a smaller interference with the owner's control of his property. Chief Justice Rehnquist has argued that *Midkiff* provides the right standard for assessing regulatory legislation. *Keystone Bituminous Coal Assoc. v. DeBenedictis*, 480 U.S. 470, 511 n.3 (1987) (dissenting opinion).

long accepted understandings of the distinct roles of judges and elected representatives, it tramples on important virtues of federalism. The sovereign powers of the states can be impaired as surely by federal judges wielding expansive interpretations of vague constitutional provisions as by Congress passing the limits on its enumerated powers or commandeering state agencies, as in, for example, *United States v. Morrison*, 529 U.S. 598 (2000) and *New York v. United States*, 505 U.S. 144 (1992). The Court wisely has long heeded the admonition of Justice Brandeis that open-ended review under the Fourteenth Amendment poses a special threat when a state may "serve as a laboratory" trying "novel social and economic experiments," because broad, non-textual review makes it easy to "erect our prejudices into legal principles." *New State Ice Co. v. Liebman*, 285 U.S. 262, 280, 311 (1932) (Brandeis, J., dissenting). State experimentation simply is not possible if a federal judge has the authority to decide, on the basis of expert testimony about "predictive facts," whether a new state law "will in fact lead to lower fuel prices." App. 25. This approaches placing a state legislature into federal receivership.

The Ninth Circuit has not offered any reasoned justification for imposing a more demanding standard on land use or rent control regulation. The court below followed its own *Richardson* precedent, also striking down a rent control provision, which mechanically quoted the "substantially advance" language from *Agins* and drew an expansive command from this Court's decision in *Yee v. City of Escondido*, 503 U.S. 519 (1992). In *Yee*, the Court did suggest in dicta that rent control laws could be amenable to the "substantially advance" test restated in *Nollan v.*

California Coastal Commission, 483 U.S. 825 (1987), but such authority hardly justifies the intrusive measurement of efficacy directed here. First, *Nollan* actually employed a quite deferential standard, requiring only a "logical nexus" between a regulation and goal, something found by the District Court to be present here. App. 55-56. Moreover, to the extent *Nollan* requires greater scrutiny, *Del Monte Dunes* has made it apparent that *Nollan* applies only to permanent physical occupations, not mere regulations, as explained above, at 9.

Yee also suggested that the ability of a tenant to capture the difference between regulated rent and market rent in conveying his leasehold to a new tenant "might have some bearing" on whether the ordinance was valid. 503 U.S. at 530. Hawaii does not dispute that lessees' capture of regulatory savings should be considered in assessing the rationality of the statute. But *Yee* nowhere even hints that the ability of a lessee to convey his interest *ipso facto* elevates the scrutiny to which the statute is subject or casts onto the state a duty to prove that the ordinance will work.

The Ninth Circuit explicitly ruled that all land use regulation must meet this test. Its decisions stand in stark conflict with many decisions in other circuits employing a highly deferential standard in Due Process challenges to state and local government land use regulations, including rent control ordinances. The Fourth Circuit, for example, has stated that challenges to land use laws "can survive only if the alleged purpose behind the state action has no conceivable rational relationship to the exercise of the state's traditional police power through

zoning." *Sylvia Development Corp. v. Calvert County, Maryland*, 48 F.3d 810, 827 (4th Cir. 1995). The Seventh Circuit even requires a property owner to show that an adverse zoning decision not only is arbitrary and irrational, but also show the violation of another constitutional right or that state law does not provide an adequate remedy. *New Burnham Prairie Homes v. Village of Burnham*, 910 F.2d 1474, 1481 (7th Cir. 1990). It would be difficult to overstate the aversion of most lower federal courts to open-ended review of local land use decisions under standards such as endorsed by the Ninth Circuit here. *See, e.g., RRI Realty Corp. v. Incorporated Village of Southhampton*, 870 F.2d 54 (2d Cir. 1989) (refusing to entertain substantive due process challenge to denial of permit unless plaintiff preliminarily can show an entitlement to it under state law).

The Ninth Circuit's ruling also conflicts directly with important recent decisions by the highest courts of California and New York interpreting the *Agins* "substantially advance" formula so as to preserve traditional legislative discretion. In *Santa Monica Beach, supra*, the California Supreme Court sustained the granting of a demurrer to a takings challenge to a city rent control law, where the plaintiff wished to try to show that the law failed to achieve its goals, the factual inquiry ordered by the Ninth Circuit in this case. The Court stated: "In sum, with rent control, as with most other such social and economic legislation, we leave to legislative bodies rather than to the courts to evaluate whether the legislation has fallen so far short of its goals as to warrant repeal or amendment." 968 P.2d at 1007. The conflict over respective willingness to second guess legislation between the Ninth Circuit and the California Supreme Court will draw

floods of litigants into federal as opposed to state courts in our largest state. Similarly, the New York Court of Appeals, in "easily" sustaining a town's zoning amendments, held that the *Agins* means-ends test only requires that land use laws bear a "reasonable relationship" to legitimate objectives, an approach indistinguishable from traditional due process analysis. *Bonnie Briar Syndicate v. Mamaroneck*, 721 N.E. 2d 971 (N.Y. 1999).

Justice Kennedy recently lamented that "[t]he imprecision of our regulatory takings doctrine does open the door to normative considerations about the wisdom of government decisions." *Eastern Enterprises v. Apfel*, 524 U.S. 498, 539, 545 (Kennedy, J., concurring in part and dissenting in part). This is a case where the Ninth Circuit's interpretation requires federal courts to strike down legislation when it concludes that elected legislators have made an unwise estimate of the benefits of legislation. This Court urgently needs to restore the correct balance between federal judicial power and state political processes.

III. Review Should Be Granted Because This Case Presents an Important and Clear-Cut Issue That Has Present Consequences for States in the Ninth Circuit and Will Control Further Conduct of This Case.

The Court should grant review in this case, even though the Ninth Circuit remanded for a trial. The Ninth Circuit has clearly and finally established the legal standard to be applied, and it is cleanly presented for review in this case. Subsequent litigation will subject Hawaii to the need to defend the wisdom of its legislation and the

prescience of its legislators. As in *United States v. General Motors*, 323 U.S. 373, 377 (1945), another takings case where the Court of Appeals had remanded for trial under a troubling legal standard, the decision below is "fundamental to the further conduct of the case." *See also Gillespie v. United States Steel Corp.*, 379 U.S. 148, 153 (1964).

That the standard adopted below conflicts with numerous decision of this and other courts, as we show above, provides further reason for immediate review. *Forsyth v. City of Hammond*, 166 U.S. 506, 514-15 (1897); *accord, General Motors*, 323 U.S. at 374; *Michael v. United States*, 454 U.S. 950, 951 (1981) (White, J., dissenting).

Most importantly, the issue is important and has present consequences for Hawaii and other states. *Mazurek v. Armstrong*, 520 U.S. 968, 975-76 (1997). The Ninth Circuit rule subjects land use and rent control legislation over the western part of the United States to intrusive federal court oversight in violation of principles of both separation of powers and federalism. As a result, it invites a plethora of inappropriate and expensive litigation challenging the efficacy of many state and local laws. The lower courts struggle in present confusion about the governing principles. The Court would not serve well either the states or the lower courts to postpone decision on these issues until the conclusion of trial and further appeal in this case.

CONCLUSION

For the reasons stated, this petition for certiorari should be granted.

Respectfully submitted,

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FOR PUBLICATION

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

CHEVRON USA, INC., a Pennsylvania Corporation, *Plaintiff-Appellee,* v. BENJAMIN J. CAYETANO, Governor of the State of Hawaii; EARL I. ANZAI,* Attorney General of the State of Hawaii, *Defendants-Appellants.*	No. 99-15108 D.C. No. CV-97-00933-ACK OPINION

Appeal from the United States District Court for the District of Hawaii
Alan C. Kay, District Judge, Presiding

Argued and Submitted
November 4, 1999 – Honolulu, Hawaii

Filed September 13, 2000

Before: Dorothy W. Nelson, Robert R. Beezer, and William A. Fletcher, Circuit Judges.

Opinion by Judge Beezer; Concurrence by Judge W. Fletcher

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*Earl I. Anzai is substituted for his predecessor Margery S. Bronster, as Attorney General for the State of Hawaii. Fed. R. App. P. 43(c)(2).

COUNSEL

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OPINION

BEEZER, Circuit Judge:

Hawaii Governor Benjamin J. Cayetano and Attorney General Earl I. Anzai (collectively "the State") appeal the district court's judgment in favor of Chevron U.S.A., Inc. Chevron filed suit for declaratory and injunctive relief against enforcement of Section 3(c) of Act 257 of the 1997 Hawaii State Legislature ("Act 257"). Act 257, inter alia, proscribes the maximum rent that oil companies can collect from dealers who lease company-owned service stations. Both parties moved for summary judgment on whether the maximum permissible regulated rent effects an unconstitutional regulatory taking. After concluding that it does, the district court granted Chevron's motion and denied the State's motion. The State appeals only the grant of summary judgment to Chevron; it does not appeal the denial of its own motion. We have jurisdiction under 28 U.S.C. § 1291. Because genuine issues of material fact exist, we vacate the judgment and remand for further proceedings.

I

In response to concerns about the highly concentrated gasoline market in Hawaii and the resulting high cost of gasoline to consumers, the Hawaii Legislature enacted Act 257 on June 21, 1997.[1] Act 257, inter alia, regulates the maximum rent an oil company can charge dealers who lease its service stations.

Chevron is one of two gasoline refiners and one of six wholesalers in Hawaii. At the retail level, Chevron sells most of its gasoline through company-owned stations, which are leased to independent dealers. Chevron leases 64 service stations to dealers in Hawaii. From 1984 through the end of 1996, Chevron relied on *estimated* gasoline sales to calculate the rent owed by the lessee dealers. After determining that the amount of gross rent receipts was not satisfactory, Chevron initiated a new nationwide dealer rental program in January 1997. Chevron restructured the manner in which it calculated lease rates. This program, which the parties agree would be in effect in Hawaii absent Act 257, requires the lessee dealer to pay a monthly rent, consisting of an escalating percentage of the dealer's gross margin on actual, rather than estimated, gasoline sales. For instance, the rent would be calculated as 18% of the gross margin up to $18,000; 32% of the portion between $18,000 and $28,000; and 38% of the portion over $28,000. In contrast, Act 257 establishes a maximum regulated rent of 15% of gross margin.

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[1] The relevant portions of Act 257 were later codified as Hawaii Revised Statute § 486H-10.4.

The maximum rents Chevron projects it could receive under the statutory scheme imposed by Act 257 totals $6,126,646 for 1998. Chevron's projected expenses total $6,292,855, exceeding Chevron's projected rental income by $166,209. Chevron concedes, however, that it has not fully recovered its expenses relating to dealer stations (including ground lease rents, real property taxes, ordinary maintenance and depreciation) from rent in any state in the last 20 years.

Instead, Chevron relies on supply contracts to earn a profit. Dealers who choose to rent a station from Chevron must, as a condition of their lease, agree to purchase from Chevron all of the fuel necessary to satisfy demand at that station for Chevron gasoline. The price under the supply contract is unilaterally set by Chevron. Both the lease agreement and the supply contract permit the dealer to transfer his or her occupancy rights upon obtaining Chevron's written consent and paying a transfer fee set by Chevron. Act 257 does not prohibit such transfers.

In conjunction with the alienability of the leaseholds, the parties stipulated to the following facts:

> 34. The existing dealer at the time of the enactment of Act 257 may be able to sell his leasehold at a premium that derives from the value of the dealer's leasehold interest, given the reduced rent imposed by Act 257, assuming Chevron does not object in good faith when the selling dealer seeks Chevron's consent to the assignment.
>
> 35. Assuming everything else remains equal, the market value of the lessee-dealer leasehold

reasonably could be expected to increase as the amount of the rent payable decreases.

Based largely on these facts, Chevron moved for summary judgment on its takings claim.[2] Chevron argued that Act 257 effects a regulatory taking because it fails to substantially advance a legitimate state interest. Chevron also maintained that Act 257 prevents the company from receiving a just and reasonable return. Finally, Chevron contended that Act 257 is unconstitutional because it neither provides individualized consideration, nor contains a mechanism for obtaining relief from confiscatory rent cap provisions. Because the district court resolved the first argument in Chevron's favor, it declined to reach the other two.

On appeal, the State challenges both the standard used by the district court to evaluate Chevron's regulatory taking claim and the court's application of that standard in the summary judgment context.

II

"States have broad power to regulate . . . the landlord-tenant relationship . . . without paying compensation for all economic injuries that such regulation entails." *Loretto v. Teleprompter Manhattan CATV Corp.*, 458 U.S. 419, 440 (1982). When a landowner decides to rent his land to tenants, the government may place ceilings on the rents the landowner can charge. *See, e.g., Pennell v. San*

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[2] Chevron's other three claims (42 U.S.C. § 1983, due process and equal protection) were dismissed without prejudice by stipulation of the parties and are not at issue in this appeal.

Jose, 485 U.S. 1, 11-12 (1988). "[W]hile property may be regulated to a certain extent, if regulation goes too far it will be recognized as a taking." *Pennsylvania Coal Co. v. Mahon*, 260 U.S. 393, 415 (1922).

The question in this case is whether Act 257 goes too far. To analyze that question, the district court concluded that "the appropriate inquiry is whether [Act 257] substantially advances a legitimate state interest." In reaching this conclusion, the court explicitly rejected the more deferential standard urged by the State. The State argues that the courts should look only to whether "the Legislature rationally could have believed the Act would substantially advance a legitimate government purpose."[3]

To support this position, the State relies on a footnote in Chief Justice Rehnquist's dissenting opinion in *Keystone Bituminous Coal Association v. DeBenedictis*, 480 U.S. 470 (1987):

> [O]ur inquiry into legislative purpose is not intended as a license to judge the effectiveness of legislation. When considering the Fifth Amendment issues presented by Hawaii's Land Reform Act, we noted that the Act, "like any other, may not be successful in achieving its intended goals. But 'whether in fact the provisions will accomplish the objectives is not the

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[3] Both the test used by the district court and that suggested by the State require a legitimate state interest. In this case, the district court found that the purpose of Act 257 is to "reduc[e] gasoline prices for Hawaii's consumers." On appeal, the parties do not contest this finding. Likewise, the parties do not dispute the legitimacy of this interest.

> question: the [constitutional requirement] is satisfied if . . . the . . . [State] Legislature rationally could have believed that the [Act] would promote its objective.' " *Hawaii Housing Authority v. Midkiff*, 467 U.S. 229, 242 (1984).

Keystone, 480 U.S. at 511 n. 3 (alterations in original). The State's reliance on this quote is unsound for two reasons. First, as the district court correctly noted, Midkiff dealt with a physical taking, rather than a regulatory one. In a physical taking, the government exercises its eminent domain power to take private property for "public use." Importantly, the government intends to take the property and is willing to pay compensation to the landowner. We have recognized that a more deferential standard applies in those circumstances. *See Richardson v. City and County of Honolulu*, 124 F.3d 1150, 1158 (9th Cir. 1997), *cert. denied*, 119 S.Ct. 168 (1998) ("[W]e see nothing inconsistent in applying heightened scrutiny when the taking is uncompensated, and a more deferential standard when the taking is fully compensated."); *see also Hall v. City of Santa Barbara*, 833 F.2d 1270, 1280 n. 25 (9th Cir. 1986) ("It makes considerable sense to give greater deference to the legislature where it deliberately resorts to its eminent domain power than where it may have stumbled into exercising it through actions that incidentally result in a taking.").

Second, the State's argument is foreclosed by our decision in *Richardson*. In *Richardson*, we established that land use regulations, including rent control ordinances like Act 257 that permit the capture of a premium, do not effect a taking if the regulation "substantially furthers a legitimate state interest." *Richardson*, 124 F.3d at 1164; *see*

also Keystone, 480 U.S. at 485 ("[L]and use regulation can effect a taking if it 'does not substantially advance legitimate state interests, . . . or denies an owner economically viable use of his land.' ") (quoting *Agins v. Tiburon*, 447 U.S. 255, 260 (1980)).

III

While we recognize the concurring opinion's dissatisfaction with our application of the "substantially advances" test, we do not believe that our holding today either expands *Richardson* or contravenes Supreme Court precedent.

Relying on *Pennell v. City of San Jose*, 485 U.S. 1 (1988), the concurrence asserts that rent control can ordinarily only be challenged as violative of due process, rather than as a regulatory taking. We read *Pennell* differently. In that case, a landlord challenged the constitutionality of a city rent control ordinance on three grounds: (1) the Takings Clause; (2) Due Process; and (3) Equal Protection. *See id.* at 4. The Court summarized the Takings Clause claim as follows:

> § 5703.28 of the Ordinance establishes the seven factors that a hearing officer is to take into account in determining the reasonable rent increase. The first six of these factors are all objective, and are related either to the landlord's costs of providing an adequate rental unit, or to the condition of the rental market. Application of these six standards results in a rent that is "reasonable" by reference to what appellants contend is the only legitimate purpose of rent control: the elimination of "excessive" rents

> caused by San Jose's housing shortage. When the hearing officer then takes into account "hardship to a tenant" pursuant to § 5703.28(c)(7) and reduces the rent below the objectively "reasonable" amount established by the first six factors, this additional reduction in the rent increase constitutes a "taking."

Id. at 9.

The Takings Clause claim in *Pennell* was not based on the mere existence of rent control, but was instead dependent on the hardship provision. Indeed, because rent control is not a per se taking, *see FCC v. Florida Power Corp.*, 480 U.S. 245, 252 (1987), the landlord had to argue why this particular rent control ordinance effected a taking. To do so, he focused on the hardship provision, as the other factors apparently established a reasonable rent. The Court neither explicitly nor implicitly approved or disapproved of the landlord's argument. In fact, the Court declined to reach the merits of the Takings Clause claim because the hardship provision had never been applied. *See Pennell*, 485 U.S. at 9-10. The Court did proceed to analyze the landlord's remaining constitutional arguments. It did not, however, intimate in any way that rent control provisions should *only* be analyzed under the Due Process Clause. Rather, the Court determined that the Takings Clause claim was premature and then analyzed the Due Process Clause claim under the Due Process "reasonableness" test.

Moreover, to the extent that "something else" is required to challenge a rent control ordinance under the Takings Clause, the existence of the premium in this case suffices. The stipulated possibility that an incumbent

dealer will be able to capture the value of the decreased rent in the form of a premium separates Act 257 from an ordinary rent control situation, where such a transfer is prohibited.

Logically, it makes far more sense for us to analyze Chevron's regulatory takings claim under the Takings Clause test than it does to review it under the Due Process Clause test. Chevron raised a Due Process Clause claim in its First Amended Complaint, but chose not to move for summary judgment on that claim. Once the district court in this case granted Chevron's summary judgment motion on the Takings Clause claim, Chevron dismissed its remaining claims without prejudice. Thus, there is no Due Process claim for us to review, even if we were so inclined.

The concurring opinion also downplays the significance of the Supreme Court's language in *Yee v. City of Escondido*, 503 U.S. 519 (1992). Although the Court in *Yee* did not conclusively announce the applicable test for a regulatory takings challenge to a rent control statute, it did suggest that the possibility of a premium similar to the one in this case "might have some bearing on whether the ordinance causes a regulatory taking, as it may shed some light on whether there is a sufficient nexus between the effect of the ordinance and the objectives it is supposed to advance." *Id.* at 530. The Court then cited *Nollan v. California Coastal Commission*, 483 U.S. 825 (1987), which employs the "substantially advances" test.

The *Yee* Court went slightly further than in *Pennell* and held that the facial regulatory takings challenge was ripe. *See Yee*, 503 U.S. at 534. The Court did not reach the

merits of the regulatory takings claim, however, because it concluded that the issue was not fairly presented in the certiorari petition. *See id.* at 537. In reaching that conclusion, the Court noted that "were we to address the issue here, we would apparently be the first court in the Nation to determine whether an ordinance like this one effects a regulatory taking." *Id.* at 538.

Although the Court recognized the novelty of the regulatory takings claim, it did not take any position on its merits. The ordinance in *Yee* is very similar to Act 257, in that the transfer of the mobile homes in *Yee* and the service station leaseholds here both create the possibility of a one-time transfer of wealth in the form of a premium that inures to incumbent lessees. Had the Court in *Pennell* rejected a regulatory takings challenge such as the one posed by Chevron in the instant case, as the concurring opinion suggests, the Court in *Yee* would not have needed to expressly decline to reach the issue. We believe that the Court's treatment of the regulatory takings issue in *Yee* further undermines the concurrence's reading of *Pennell*.

City of Monterey v. Del Monte Dunes at Monterey, Ltd., 526 U.S. 687 (1999), gives additional support to the application of the "substantially advances" test to Chevron's Takings Clause claim. Although the Court recognized that it has not provided a "thorough explanation of the nature or applicability of the requirement that a regulation substantially advance legitimate public interests outside the context of required dedications or exactions," it noted that the jury instructions given by the trial court regarding the "substantially advances" test were consistent with the Court's previous general discussions of regulatory takings liability. *Id.* at 704. As support for this

statement, the Court cited several land use regulatory takings cases, including *Yee*. *See id.* It is apparent to us that the Court viewed the rent control ordinance in *Yee* in the same manner as the land use regulations in the other cases. It is further apparent to us that when challenged as a regulatory taking, each is subject to the same "substantially advances" test.

We have great difficulty finding Supreme Court precedent to support the concurring opinion's assertion that rent control should be viewed differently than other land use regulations. *Accord Santa Monica Beach, Ltd. v. Superior Court*, 968 P.2d 993, 1021 (Cal. 1999) (Baxter, J., dissenting) ("[W]e cannot assume that decisions upholding other forms of price control are authority for rejecting a takings clause challenge to a rent control ordinance.").

The concurring opinion also does not satisfactorily explain how to deal with *Richardson*. *Richardson* is the law of our circuit and has conclusively answered the question of what test should be applied in this case. Nevertheless, the concurring opinion attempts to avoid the holding of *Richardson* by inventing a "certainty" requirement that does not exist. The concurrence would limit the "substantially advances" test to cases in which "the existence of the premium capture is essentially beyond dispute." We do not believe that *Richardson* may faithfully be read so narrowly.[4]

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[4] We also do not believe that our decision today expands the holding of *Richardson*. We save for another day the question of whether the "substantially advances" test applies outside the context of rent control statutes that permit the capture of a premium.

Finally, we note that other federal cases have applied the "substantially advances" test in considering a regulatory takings challenge to a rent control ordinance. *See Federal Home Loan Mortgage Corp. v. New York State Div. of Hous. and Community Renewal*, 83 F.3d 45, 48 (2d Cir. 1996) (concluding that rent stabilization law does not constitute either physical or regulatory taking); *Greystone Hotel Co. v. City of New York*, 13 F.Supp.2d 524, 527-29 (S.D.N.Y.) (concluding that rent stabilization provision substantially advanced a legitimate state interest and thus did not effect a regulatory taking); *Adamson Cos. v. City of Malibu*, 854 F.Supp. 1476, 1501-02 (C.D.Cal.1994) (concluding that city's mobile home rent control ordinance was substantially related to a legitimate interest).

In sum, we disagree with the concurrence's position that we should apply the "reasonableness" test to evaluate Chevron's regulatory takings claim. The correct test is "whether the legislation substantially advances a legitimate state interest," as discussed above, as suggested by the Supreme Court in *Yee*, as used by the district court in this case, and as established by this court in *Richardson*.

IV

Although the district court applied the correct standard, it should not have granted summary judgment. Notwithstanding the fact that both sides moved for summary judgment and agreed that summary judgment was

appropriate one way or the other, genuine issues of material fact remain.[5]

We review a district court's grant of summary judgment de novo. *See Balint v. Carson City*, 180 F.3d 1047, 1050 (9th Cir. 1999) (en banc). We determine, viewing the evidence in the light most favorable to the nonmoving party, whether the district court correctly applied the relevant substantive law and whether there are any genuine issues of material fact. *See id.* Because Chevron challenges Act 257 on its face, rather than as applied, Chevron bears the burden of proving by a preponderance of the evidence that the regulation does not substantially advance a legitimate state interest. *See City of Monterey v. Del Monte Dunes at Monterey, Ltd.*, 526 U.S. 687, 700-01 (1999).

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[5] At least one court has held that, under similar circumstances involving cross-motions for summary judgment, a party that failed to raise the existence of genuine issues of material fact before the district court waived the right to do so on appeal. *See Shrink Missouri Gov't PAC v. Maupin*, 71 F.3d 1422, 1423 (8th Cir. 1995). Even then, however, the court proceeded to analyze whether genuine issues of material fact remained. The better-reasoned approach holds that the district court is responsible for determining whether the requirements of Federal Rule of Civil Procedure 56 are met, whether or not the parties believe that they are. *See, e.g.*, William W Schwarzer et al., *The Analysis and Decision of Summary Judgment Motions*, 139 F.R.D. 441, 499 (Feb.1992) ("The filing of cross-motions does not ensure that summary judgment is in order.").

A

The State argues here that Chevron was not entitled to summary judgment because the district court ignored genuine issues of fact raised by the affidavit of its expert economist, Dr. Keith Leffler. Chevron, in its moving papers, relied solely on the stipulated fact that an existing dealer may be able to sell his leasehold at a premium that derives from the increased value of the dealer's leasehold interest due to the reduced rent imposed by Act 257. Based on this possible premium transfer, Chevron argued that the benefits of Act 257 will inure to the incumbent dealer, rather than to consumers. Thus, according to Chevron, Act 257 does not substantially advance its purpose of lowering gasoline prices.

The State relied on Dr. Leffler to rebut Chevron's argument. In his affidavit, Dr. Leffler asserted that Act 257 is likely to lessen the adverse competitive effects that result from the highly concentrated gasoline market in Hawaii and thereby benefit consumers. This is so, according to Dr. Leffler, because lower monthly rent payments reduce a dealer's cost of continued operation, meaning more dealers are likely to stay in business. The presence of more dealers means a greater supply of fuel to consumers and a greater supply leads to lower prices. Therefore, Dr. Leffler predicted that the rent cap would act to lower retail gasoline prices. Although Dr. Leffler acknowledged that an oil company could raise the wholesale cost of gasoline to dealers in order to make up for lost rent, he believed that wholesale oil suppliers would be unlikely to do so because such action would lead directly to reductions in volume as dealers would react by raising their street price. He also believed that while a

premium transfer was possible, an incumbent dealer could not be expected to capture the net present value of the reduced rent because the net present value would depend on too many unknown variables, such as the oil company's rent policy, the future level of gasoline margins, and the sales of goods other than gasoline. Even if new lessee dealers could estimate the present value of rent reductions accurately, Dr. Leffler stated that any cost reductions would be fully captured by incumbent dealers only if the market for the sale of lessee dealer rights was perfectly competitive. Relying on the stipulated facts, which indicate that less than three sales of dealer rights occur per year, Dr. Leffler concluded that the market is relatively thin, rather than perfectly competitive. Finally, because Act 257 encourages dealers to stay in business longer by lowering fixed costs, Dr. Leffler asserted that Act 257 will benefit consumers even if the premium is fully captured.

In response to Dr. Leffler, Chevron proffered an affidavit from its own expert economist Dr. John Umbeck. Dr. Umbeck's opinion differs significantly from that of Dr. Leffler. Dr. Umbeck believes that Act 257 will reduce the net present value of an oil company's rental revenue and thereby discourage oil companies from building new stations or maintaining old ones. Accordingly, Dr. Umbeck asserted that Act 257 will actually increase the concentration of Hawaii's gasoline market, rather than decrease it. Because Dr. Umbeck believes that there will be fewer stations in the long run, he states that the demand facing surviving dealers will increase, thus motivating and allowing them to raise fuel prices. Finally, Dr. Umbeck disputes Dr. Leffler's conclusion that the

market for the sale of lessee dealer rights is thin. Dr. Umbeck believes that the premium value of the capped rent will be fully captured by the incumbent dealer.

The conflicting affidavits establish that genuine issues of fact remain as to whether Act 257 will result in lower gasoline prices. Whether, and to what extent, Chevron will raise its wholesale price of fuel to compensate for lost rent, and whether, and to what extent, incumbent dealers will capture the value of the capped rent in the form of a premium upon transfer of the leasehold, remain as unanswered questions. Moreover, to the extent that the district court purported to answer these questions, such resolution was premature.[6]

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[6] That the district court engaged in improper fact-finding is apparent from its summary judgment order. For instance, the court found, despite evidence to the contrary, that "[b]ecause oil companies can simply raise their wholesale prices to the same extent that rent decreases, the dealer is likely to be unaffected by the rent cap, and gas prices will remain unchanged."

Because this case will be tried to the court, rather than a jury, the question arises whether it was improper for the district court to engage in fact-finding, since it will eventually be called upon to perform that very task. This court has held that if the parties agree that all of the underlying material facts are reflected in the written record, a judge may decide factual issues and essentially convert cross-motions for summary judgment into submission of the case for trial on the written record. *See Starsky v. Williams*, 512 F.2d 109, 111 (9th Cir. 1975). The court noted, however, that that result was justified by the unique circumstances of that case. *See id.* Moreover, the court later cautioned that such fact-finding is not appropriate on an undeveloped factual record. *See TransWorld Airlines, Inc. v. American Coupon Exchange, Inc.*, 913 F.2d 676 (9th Cir. 1990). There, the court stated:

Admittedly, these are questions of predictive fact, rather than historical fact. Nevertheless, summary judgment is no more appropriate when predictive facts are disputed. *See Washington Post Co. v. United States Dep't of Health and Human Servs.*, 865 F.2d 320, 326 (D.C.Cir. 1989) (reversing summary judgment based on conflicting experts' predictions). In *Washington Post*, the plaintiff sought access under the Freedom of Information Act, 5 U.S.C. § 552, to certain financial disclosure forms filed by National Cancer Institute consultants. *See id.* at 321. The district court granted summary judgment in favor of the

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> [W]here the ultimate fact in dispute is destined for decision by the court rather than by a jury, there is no reason why the court and the parties should go through the motions of a trial if the court will eventually end up deciding on the same record. However, just as the procedural shortcut must not be disfavored, courts must not rush to dispose summarily of cases – especially novel, complex, or otherwise difficult cases of public importance – unless it is clear that more complete factual development could not possibly alter the outcome and that the credibility of the witnesses' statements or testimony is not at issue. Even when the expense of further proceedings is great and the moving party's case seems to the court quite likely to succeed, speculation about the facts must not take the place of investigation, proof, and direct observation.

Id. at 684-85. Although the parties in this case submitted a Stipulation of Facts, there is no clear indication, as there was in *Starsky*, that all of the relevant facts are contained in the written record. In fact, in the Stipulation itself, the parties clearly reserve the right to rely on other statements. Therefore, we hold that the district court erred in resolving factual disputes at this stage, even though it must do so later.

government. On appeal, the D.C. Circuit held that a genuine issue of material fact existed as to the effect of disclosure on the government's ability to obtain the information it needed from its scientist-consultants. *See id.* In so holding, the court reviewed the evidence in the record and concluded that the conflicting affidavits created a genuine issue of fact regarding the consequences of disclosing the sought-after information. The court explicitly rejected the trial court's explanation that

> [r]esolution of this dispute involves an analysis of the potential, hypothetical impairment the government might suffer. . . . Due to the nature of the inquiry, there is no definitive proof that may be adduced by either side in support of their respective contentions. At best, the parties may provide the Court with speculation from individuals who speak with varying degrees of authority.

Id. at 324. The court held that the district court had "short-circuited the fact-finding process." *Id.* at 326. The court further explained that:

> "Factual" issues like those presented here are rarely susceptible to definitive proof. Rather, "factual" issues that involve predictive facts almost always require a court to survey the available evidence, to credit certain pieces of evidence above others, and to draw cumulative inferences until it reaches a judgmental conclusion. In the end, the court makes its best assessment about what is most likely to happen in the future. In such an inquiry, the ultimate "facts" in dispute are most successfully approached when

> all relevant evidentiary underpinnings are fully developed.

Id. at 326.

As in *Washington Post*, the experts' conflicting predictions here created genuine issues of fact. A proper evaluation of Act 257 depends upon further development of the experts' underlying facts. Although both experts based their opinions on the stipulated facts, they also rely on other unproven factual assumptions. In order to determine whose predictions are more accurate, there needs to be a better understanding of the competitiveness of the market for the sale and purchase of lessee dealer rights and the elasticity of demand for gasoline. This can be attained only through additional factual development and cross-examination of the parties' expert witnesses. Cross-examination is particularly appropriate here because it is necessary for the court to evaluate the witnesses' credibility in order to evaluate their expert opinions. By adopting the predictions of Chevron's expert without the benefit of this needed information, the district court "short-circuited the fact-finding process."

B

Issues of fact do not preclude summary judgment unless they are material to the substantive claim at issue, that is, unless they "might affect the outcome of the suit under the governing law." *Moreland v. Las Vegas Metro. Police Dep't*, 159 F.3d 365, 369 (9th Cir. 1998) (quoting *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 248 (1986)).

The factual disputes here are material only if their resolution would alter whether Act 257 "substantially advances a legitimate state interest."

In order to determine materiality, we first determine what is required by the "substantially advances" test. Obviously, a connection of some sort must be established between Act 257's means (that is, a maximum regulated rent) and the intended end (lower gas prices). The question arises whether the mere possibility that the rent cap will not achieve its purpose is sufficient to destroy this nexus. The district court, relying on *Richardson*, believed this to be the case. If that belief is correct, the factual disputes are not material because the parties concede that that possibility exists. If, however, the standard requires a closer evaluation of the likelihood that the means will achieve the end, then these disputes are material.

In *Richardson*, we held that a Honolulu ordinance that imposed a cap on rent for land under condominium units was an unconstitutional regulatory taking. The court concluded that:

> The absence of a mechanism that prevents lessees from capturing the net present value of the reduced land rent in the form of a premium, means that the Ordinance will not substantially further its goal of creating affordable owner-occupied housing in Honolulu. Incumbent owner occupants who sell to those who intend to occupy the apartment will charge a premium for the benefit of living in a rent controlled condominium. The price of housing ultimately will remain the same. The Ordinance thus effects a regulatory taking.

124 F.3d at 1166. Importantly, our conclusion in *Richardson* was based on the district court's findings that incumbent owners *will* charge a premium and that the price of housing *will* remain the same. Apparently, these findings were not contested on appeal.

Whether the price of gasoline will remain the same here is vigorously contested. The mere possibility that it will does not satisfy Chevron's burden of proving that Act 257 does not substantially further its purpose. Logically, there must be a determination of the likelihood of that possibility. Otherwise, regulatory legislation would be unconstitutional any time it was not absolutely guaranteed to achieve its purpose. Would a statute that was 95% likely to be effective fail to substantially advance its interest simply because there was a 5% chance that it would not achieve its goal? What if the statute was 99% effective? Surely the 1% chance that it would be ineffective does not, as a matter of law, mean that the statute does not "substantially advance" its purpose.

Not only does such a reading of *Richardson* fail the logic test, but it also fails to consider the language. Had the test been intended to require an absolute cause-and-effect relationship, the word "substantially" would have no meaning. For these reasons, the district court improperly relied on *Richardson* to conclude that the absence of a mechanism that prevents a premium transfer necessarily destroys the constitutionally-required connection.

The State argues that the existence of a premium is not relevant. As discussed in Section III above, however, the Supreme Court recognized this relevance in *Yee*, 503 U.S. at 530. While the existence of a premium transfer had

nothing to do with a physical taking, the Court stated that "[t]his effect might have some bearing on whether the ordinance causes a regulatory taking, as it may shed some light on whether there is a sufficient nexus between the effect of the ordinance and the objectives it is supposed to advance." *Id.* The Supreme Court did not hold that the possibility of a premium transfer necessarily defeated that connection; it recognized only that it "might have some bearing" on it. *Id.*

The question remains as to what exactly the connection does require. In a candid statement, the Supreme Court recently acknowledged that it has not provided a "thorough explanation of the nature or applicability of the requirement that a regulation substantially advance legitimate public interests outside the context of required dedications or exactions. . . . " *City of Monterey*, 526 U.S. at 704. In *City of Monterey*, the Court affirmed judgment in favor of Del Monte Dunes, a property owner who contended that the city's repeated rejections of its plans for development effected an unconstitutional regulatory taking. The Court held that the case was properly submitted to a jury. Although the Court refused to consider the City of Monterey's challenge to the jury instructions, as the City itself had proposed their essence, the Court nonetheless noted that the following jury instructions were consistent with the Court's previous discussions of regulatory takings liability:

> "Public bodies, such as the city, have the authority to take actions which substantially advance legitimate public interest[s]. . . . So one of your jobs as jurors is to decide if the city's decision

> here substantially advanced any such legitimate public purpose.
>
> "The regulatory actions of the city or any agency substantially advanc[e] a legitimate public purpose of the action bears a reasonable relationship to that objective.
>
> "Now, if the preponderance of the evidence establishes that there was no reasonable relationship between the city's denial of the . . . proposal and legitimate public purpose, you should find in favor of the plaintiff. If you find that there existed a reasonable relationship between the city's decision and a legitimate public purpose, you should find in favor of the city. As long as the regulatory action by the city substantially advances their [sic] legitimate public purpose, . . . its underlying motives and reasons are not to be inquired into."

526 U.S. at 700-01. Based on these instructions, a challenged regulatory action "substantially advances" its interest if it bears a reasonable relationship to that interest.

Understanding what the "substantially advances" test requires also depends to some extent on understanding what it does not require. In *City of Monterey*, the Court declined to extend the "rough proportionality" test beyond the special context of exactions – land use decisions conditioning approval of development on the dedication of property to public use. *See id.* at 702-03. Thus, *City of Monterey* teaches that a reasonable relationship does not depend on the State's action being roughly proportional to its asserted interests.

Whether Act 257's rent cap is reasonably related to its objective of lowering fuel prices certainly depends on whether it will in fact lead to lower fuel prices. The factual issues that remain in dispute are material to the ultimate determination required in this action. We hold that the district court should not have granted summary judgment on Chevron's first argument.

C

Because the judgment can be affirmed on any basis supported in the record, we briefly consider the second and third arguments made by Chevron in its summary judgment motion, even though the district court did not. There are two ways in which a party can challenge a regulatory action on its face. The first has been thoroughly discussed above. The second depends on whether the regulation deprives an owner of the economic viability of property. An owner is not denied the economic viability of property, unless there remains no permissible or beneficial use for that property after the regulatory action. *See City of Monterey*, 526 U.S. at 700 (quoting jury instruction to that effect). Chevron has made no such showing. In fact, the evidence shows that Act 257 allows Chevron to charge approximately $1.1 million more than it would otherwise have charged under its own rental program. Although this evidence may be useful to Chevron in demonstrating the ineffectiveness of Act 257, it belies its claim of loss of economic viability.

Chevron also argues that Act 257 is unconstitutional because it fails to provide for any individualized consideration and contains no mechanism for obtaining relief

from the confiscatory rent limitation provisions. In support of this argument, Chevron relies on two state court cases and one of the two district court orders in *Richardson*. *See Cromwell Assocs. v. Mayor and Council of Newark*, 511 A.2d 1273, 1275 (N.J. Super. Ct. Law Div. 1985); *Birkenfeld v. City of Berkeley*, 550 P.2d 1001, 1028-1033 (Cal. 1976); *Richardson v. City and County of Honolulu*, 802 F. Supp. 326, 336-37 (D. Haw. 1992) ("*Richardson II*"). The precedents established in these cases do not bind us. Although addressed by the district court in *Richardson II*, in *Richardson* we declined to reach the issue on appeal. Likewise, the Supreme Court in *Permian Basin Area Rate Cases*, 390 U.S. 747, 770 (1968), refused to decide whether individualized consideration and administrative relief were "constitutionally imperative." Earlier Supreme Court cases, however, have suggested that there are no such constitutional requirements. In *Bowles v. Willingham*, 321 U.S. 503, 518 (1944), the Court stated that otherwise valid price-fixing was not improper because it was on a class rather than an individual basis. Justice Brandeis stated for a unanimous Court in *Phillips v. Commissioner*, 283 U.S. 589, 596-97 (1931), that "[w]here only property rights are involved, mere postponement of the judicial enquiry is not a denial of due process, if the opportunity given for the ultimate judicial determination of the liability is adequate." As evidenced by the instant action, Chevron was not denied an opportunity to seek judicial review of Act 257.

Finally, the cases relied upon by Chevron – *Cromwell Associates*, *Birkenfeld*, and *Richardson II* – are distinguishable because they involved ordinances that regulated a landlord's sole source of revenue. Imposing a maximum

rent removed the only mechanism by which a landlord could increase revenues in the event of an increase in costs. Chevron's lessee dealer stations provide Chevron with two sources of revenue. For the past 20 years, Chevron has relied on its lessee dealers' contractually-required purchase of gasoline to assure a reasonable rate of return on its service stations. Act 257 does not regulate this revenue source. Accordingly, Act 257's failure to contain an administrative relief provision does not result in a facial taking.

V

Genuine issues of material fact exist as to whether Act 257 will benefit consumers. Specifically, the record contains conflicting evidence as to whether incumbent dealers will capture a premium based on the increased value of their leaseholds due to the imposition of a maximum permissible regulated rent, thereby depriving new dealers and consumers from reaping the benefits of Act 257. Questions also remain as to whether oil companies will raise the wholesale price of fuel and thereby unilaterally offset the benefits of the Act. Because resolution of these factual issues is necessary to determine whether Act 257 substantially advances, or bears a reasonable relationship to, the State's interest in lowering gasoline prices, the district court erred in granting summary judgment. Summary judgment is likewise inappropriate on the other two grounds urged by Chevron.

We VACATE the judgment of the district court and REMAND for further proceedings consistent with this opinion.

W. FLETCHER, Circuit Judge, concurring in the judgment:

I disagree with the majority's analysis. Plaintiff Chevron challenges Hawaii Act 257, a rent control law limiting the amount an oil company can charge a dealer who leases a service station from the company. In a motion for summary judgment, Chevron argued that Act 257 is unconstitutional. The district court found Act 257 unconstitutional, granted Chevron's motion, and entered final judgment for Chevron. Defendant Cayetano timely appealed. We reverse and remand.

For the reasons that follow, I concur in the reversal of the grant of summary judgment to Chevron. I disagree, however, with the majority's rationale and with the task the majority has set for the district court on remand.

I

There are two distinct tests of constitutionality potentially applicable to Act 257. The first is a "reasonableness" test normally applied to rent control laws. The second is a "substantially advances a legitimate state interest" test normally applied to zoning and land use regulations. Relying on our earlier decision in *Richardson v. City and County of Honolulu*, 124 F.3d 1150 (9th Cir. 1997), the majority analyzes Act 257 under the second test. The problem in this case is not determining whether the majority has properly applied that test. The problem, rather, is determining whether the test should be applied at all.

An ordinary rent control law is constitutionally indistinguishable from a price control law. Rent control involves a price charged for real property, just as price control involves a price charged for personal property. The constitutional test for ordinary rent and price control laws is the same, regardless of whether the laws are challenged under the Due Process Clause or the Takings Clause. The test has been variously formulated, but it essentially requires that the law be "reasonable" and "not confiscatory." A few examples illustrate the point.

In *Pennell v. City of San Jose*, 485 U.S. 1, 11 (1988), the Supreme Court cited a rate regulation case in upholding a municipal rent control ordinance challenged under the Due Process Clause. The Court upheld the ordinance because it was not " 'arbitrary, discriminatory, or demonstrably irrelevant to the policy the legislature is free to adopt. . . . ' *Permian Basin Area Rate Cases*, 390 U.S. 747, 769-770 (1968)." In *FCC v. Florida Power Corp.*, 480 U.S. 245, 253 (1987), the Court upheld a rate regulation challenged under the Takings Clause as "not confiscatory." Citing the same rate regulation case as *Pennell*, it wrote that a regulation is permitted under the Constitution to— " 'limit stringently the return recovered on investment, for investors' interests provide only one of the variables in the constitutional calculus of reasonableness.' " *Id.* (citing *Permian Basin Area Rate Cases*, 390 U.S. at 769). In *In re Permian Basin Area Rate Cases*, the 1968 case cited in both *Pennell* and *FCC v. Florida Power*, the Court upheld a rate set by the Federal Power Commission without specifying whether the challenge was brought under the Due Process or Takings Clause: "any rate selected by the Commission from the broad zone of reasonableness . . . cannot

properly be attacked as confiscatory." 390 U.S. at 770. In *Bowles v. Willingham*, 321 U.S. 503, 517 (1944), the Court upheld a federal rent control law after applying the same test as for a price control law: "Of course, price control, the same as other forms of regulation, may reduce the value of the property regulated. But . . . that does not mean that the regulation is unconstitutional." Finally, in *Federal Power Commission v. Natural Gas Pipeline Co.*, 315 U.S. 575, 585 (1942), the Court upheld a rate regulation challenged under the Due Process Clause because it was "reasonable" and "not confiscatory."

Beginning with *Agins v. City of Tiburon*, 447 U.S. 255 (1980), the Supreme Court developed a more stringent test of constitutionality for zoning and land use regulation cases. The zoning ordinance in *Agins* severely limited development of privately owned land in order to preserve open space for the community. The Court upheld the constitutionality of the ordinance against a regulatory taking challenge because the ordinance "substantially advance[d] legitimate state goals." *Id.* at 261. In *Nollan v. California Coastal Commission*, 483 U.S. 825 (1987), the California Coastal Commission required owners of a beachfront house to grant a public easement across their property as a condition for receiving a permit to rebuild the house. Citing *Agins*, the Court stated, "[O]ur verbal formulations in the takings field have generally been quite different [from those applicable to due process]. We have required that the regulation 'substantially advance' the 'legitimate state interest' sought be achieved, not that the State *could rationally have decided* that the measure adopted might achieve the State's objectives." *Id.* at 834

n.3 (emphasis in original; citations and internal quotations omitted). The Court further required that the easement have a connection, or "essential nexus," to the harm that would be caused by rebuilding the house. Absent such a nexus, the required conveyance of an easement to the public would be nothing more than "extortion." *Id.* at 837. Finally, in *Dolan v. City of Tigard*, 512 U.S. 374 (1994), the city of Tigard, Oregon, required the owner of a commercial building to dedicate a portion of her property for parking and floodplain protection as a condition of receiving a permit to expand the building. The Court repeated the test from *Agins* and refined the *Nollan* "essential nexus" test. "A land use regulation does not effect a taking if it 'substantially advance[s] legitimate state interests' and does not 'den[y] an owner economically viable use of his land.' " *Id.* at 385. Further, a "required dedication" from the landowner is constitutionally permissible if it bears a "rough proportionality" to the "nature and extent of the impact of the proposed development" for which the permit is sought. *Id.* at 391.

The Supreme Court has applied the "substantially advances a legitimate state interest" test of *Agins*, and its refinement in *Nollan* and *Dolan*, only in cases of severe zoning limitations on the use of land (*Agins*) and required dedications by landowners as a condition of receiving building permits (*Nollan* and *Dolan*). *See, e.g., City of Monterey v. Del Monte Dunes at Monterey, Ltd.*, 119 S.Ct. 1624, 1635-36 (1999) ("[W]e have not extended the rough proportionality test of *Dolan* beyond the special context of exactions – land-use decisions conditioning approval of development on the dedication of property to public use. . . . [T]his Court has [not] provided . . . a thorough

explanation of the nature or applicability of the requirement that a regulation substantially advance legitimate public interests outside the context of required dedications or exactions."). In two cases, however, the Supreme Court has hinted that, in special circumstances, a rent control law might amount to a regulatory taking and might therefore be subject to the "substantially advances a legitimate state interest" test.

In 1988, the Court considered a San Jose, California, rent control ordinance in *Pennell v. City of San Jose*, 485 U.S. 1 (1988). The Court made clear that the ordinance, considered as a whole, should be analyzed under the normal reasonableness test:

> The standard for determining whether a state price-control regulation is constitutional under the Due Process Clause is well-established: "Price control is 'unconstitutional . . . if arbitrary, discriminatory, or demonstrably irrelevant to the policy the legislature is free to adopt. . . . ' " *Permian Basin Area Rate Cases*, 390 U.S. 747, 769-770 (1968).

485 U.S. at 11 (citation omitted). Applying this test, the Court sustained the rent control ordinance, holding that it represented "a rational attempt to accommodate the conflicting interests of protecting tenants from burdensome rent increases while at the same time ensuring that the landlords are guaranteed a fair return on their investment." *Id.* at 13.

The plaintiffs also brought a Takings Clause challenge to a specific provision in the ordinance that appeared to require a direct wealth transfer to a particular tenant based on the poverty of that tenant. Under the

ordinance, a landlord seeking a rent increase of more than 8% was required to go before a hearing officer who was authorized to consider, among other factors, individual hardship. If the proposed increase above 8% constituted " 'an unreasonably severe financial or economic hardship on a particular tenant,' " the increase could be denied. *Id.* at 6. The landlords contended that denial of a proposed increase on that ground would constitute a taking, but the Court refused to decide the challenge, or even to specify a test for deciding it, because the provision had never been applied and a decision would therefore be "premature." *Id.* at 9.

Next, in *Yee v. City of Escondido*, 503 U.S. 519 (1992), the Court addressed a takings challenge to an Escondido, California, mobile home rent control ordinance brought by owners of a mobile home park. As background to their challenge, the park owners pointed out that, despite their name, mobile homes are not mobile; once placed in a park, only about one mobile home in 100 is ever moved. See *id.* at 523. The park owners also pointed to California's Mobilehome Residency Law, which severely limited their ability to terminate mobile home owners' tenancies or prevent transfer of tenancies to purchasers of the mobile homes. The park owners contended that the rent control ordinance, when viewed against this background, amounted to a physical taking of their property. *See id.* at 525. The Court rejected this contention.

The park owners further contended that the ordinance constituted a regulatory taking, but the Court refused to consider the issue because it was not included

in the grant of certiorari. However, in rejecting the plaintiffs' claim of physical taking, the Court wrote the following:

> [T]he effect of the rent control ordinance, coupled with the restrictions on the park owner's freedom to reject new tenants, is to increase significantly the value of the mobile home. This increased value normally benefits only the tenant in possession at the time the rent control is imposed. . . . Petitioners are correct in citing the existence of this premium as a difference between the alleged effect of the Escondido ordinance and that of an ordinary apartment rent control statute. Most apartment tenants do not sell anything to their successors (and are often prohibited from charging "key money"), so a typical rent control statute will transfer wealth from the landlord to the incumbent tenant and future tenants. By contrast, petitioners contend that the Escondido ordinance transfers wealth only to the incumbent mobile home owner. This effect might have some bearing on whether the ordinance causes a *regulatory* taking, as it may shed some light on whether there is a sufficient nexus between the effect of the ordinance and the objectives it is supposed to advance. *See Nollan v. California Coastal Comm'n.* But it has nothing to do with whether the ordinance causes a *physical* taking.

Id. at 530 (citation omitted).

A panel of this court in *Richardson* relied on this passage from *Yee* in evaluating a Honolulu rent control ordinance. The ordinance limited long-term ground rents for residential condominiums and allowed condominium-owners/ground-lessees to sell their condominiums, and

their leaseholds, without restriction. It was clear that by selling their condominiums and leaseholds, the condominium owners could, like the mobile home owners in *Yee*, capture a premium representing the present value of the difference between the controlled rent for the ground lease and the open market rent that would be charged in the absence of the ordinance. Because of this one-time wealth transfer to the current condominium owners, *Richardson* treated the ordinance as a regulatory taking and applied the "substantially advances a legitimate state interest" test from *Agins*, *Nollan* and *Dolan*: "A land use regulation . . . does not effect a taking if it substantially furthers a legitimate state interest and does not deny the landowner economically viable use of his land. *Dolan*, 512 U.S. at 385" 124 F.3d at 1164. *Richardson* then struck down the ordinance because the ability of the owner to capture the premium by selling the condominium at an open market price meant that the ordinance did not "substantially further its goal of creating affordable owner-occupied housing in Honolulu." *Id.* at 1166.

The panel today greatly expands the holding in *Richardson*. Following the Supreme Court's suggestion in *Yee*, *Richardson* held that the "substantially advances a legitimate state interest" test was applicable in a case where it was clear that there was a premium resulting in a one-time wealth transfer from the landlord to the tenant. Absent such a transfer, the ordinance in *Richardson* would have been subject to the reasonableness test normally applied to rent control ordinances. In deciding whether to apply the "substantially advances a legitimate state interest test," the majority in this case does not first ask how clear it is that such a premium will be captured by the

lessee. Rather, it treats *Richardson* as creating a presumptive rule that rent control laws are to be evaluated under the "substantially advances a legitimate state interest" test rather than the reasonableness test: "We established in *Richardson* that land use regulations, including rent control ordinances like Act 257, do not effect a taking if the regulation 'substantially furthers a legitimate state interest.' *Richardson*, 124 F.3d at 1164." *Maj. Op.* at 11723.

When the majority says that "rent ordinances like Act 257" are subject to the "substantially advances a legitimate state interest" test, it appears to mean that the mere possibility of a premium capture by an incumbent tenant is enough to render a rent control ordinance "like Act 257." It writes, "The stipulated *possibility* that an incumbent dealer will be able to capture the value of the decreased rent in the form of a premium separates Act 257 from an ordinary rent control situation[.]" *Maj. Op.* at 11725 (emphasis added). But the possibility of premium capture exists under virtually all rent control ordinances. Even under ordinances under which subleasing and assigning are prohibited, subleasing and assigning (and resulting premium capture) are nonetheless often commonplace.

We do not know in this case whether the tenants will, in fact, capture a premium. But even without knowing this, the majority has determined that the "substantially advances a legitimate state interest" test should be used to test the constitutionality of Act 257. The majority might respond that it does not matter that, at the time of determining what test to apply, the Court does not know whether a premium will be captured. That is, if upon

investigation it turns out that there is no captured premium, the ordinance will pass the test. In other words, no harm, no foul. The problem with this response is that the constitutional test applied by the majority is not phrased in terms of whether a premium is captured. Rather, the test asks whether the rent control ordinance "substantially advances a legitimate state interest." Premium capture by the tenant is only one of many ways in which an ordinance can fail that test. Thus, if it turns out that there is, in fact, no premium capture, an ordinance may nonetheless be struck down because it fails for some other reason substantially to advance a legitimate state interest.

Even if our decision in *Richardson* was right, I believe that the majority is wrong to expand it beyond the category of cases in which the existence of the premium capture is essentially beyond dispute. I believe that in expanding the holding of *Richardson*, the majority's opinion undermines or even contradicts the Supreme Court's decisions in ordinary rent control cases such as *Pennell* and *Bowles v. Willingham*, as well as threatens its decisions in price control cases such as *FCC v. Florida Power* and the *Permian Basin Area Rate Cases*.

II

If the majority confined itself to *Richardson*, it would not be able to apply the "substantially advances a legitimate state interest" test to the facts of this case. Under the suggested analysis in *Yee*, and as I read *Richardson*, the prerequisite to the application of that test is that there be a clear capture of the premium resulting from the rent control ordinance. Because there is no clear showing in

this case that the premium will be captured by the lessees, the prerequisite for applying the test does not exist.

The factual foundation in this case is provided by a lengthy Stipulation of Facts filed in the district court. Stipulations 26 and 27 state that Chevron dealers can sell their dealerships (and associated leaseholds), and that the selling price is not limited either by Chevron's dealer lease or supply contracts or by Act 257. However, such a sale is subject to two conditions. First, Stipulation 30 states that Chevron could object to the sale in "good faith," as that term is defined by Hawaii Revised Statute § 486H-1: "The petroleum distributor shall not impose on a gasoline dealer by contract, rule, or regulation, whether written or oral, any standard of conduct that is not reasonable and of material significance to the franchise relationship." It is not clear from the materials available to us whether Chevron would be acting in good faith within this definition if it allowed a dealer to sell a dealership and leasehold only on condition that the premium resulting from Act 257 be passed on to the new dealer in calculating the sale price. Stipulation 34 suggests that such a condition might be in good faith: "The existing dealer at the time of the enactment of Act 257 may be able to sell his leasehold at a premium that derives from the value of the dealer's leasehold interest, given the reduced rent imposed by Act, assuming that Chevron does not object in good faith when the selling dealer seeks Chevron's consent to the assignment." Second, Stipulation 26 states that Chevron may require the payment of an unspecified "transfer fee" as a condition of permitting the sale of a dealership. It is not clear from the materials

before us whether such a transfer fee could include the premium resulting from Act 257.

Further, Act 257 only limits the amount of rent Chevron can charge its lessee-dealers. Chevron derives its revenue from them not only through rent, but also through the wholesale price for gasoline. Stipulation 15 states that Chevron requires its dealers, as a condition of their lease, to purchase Chevron-branded gasoline directly from Chevron. Stipulation 17 states, "Chevron recovers its expenses and investment costs of lessee dealer stations (e.g., ground-lease rent, real property taxes, ordinary maintenance, and depreciation) in Hawaii and throughout the United States through two principal revenue streams – rental revenue and earnings on Chevron gasoline sold through the stations." Stipulation 9 states, "Under a supply contract, the lessee-dealer markets Chevron motor fuels, which the lessee dealer buys from Chevron, *at a price unilaterally determined by Chevron*. Chevron does not enter into a dealer lease unless the dealer simultaneously executes a supply contract with Chevron" (emphasis added).

It is thus entirely within Chevron's power to prevent its lessee-dealers from capturing any premium resulting from Act 257. Chevron may have that power pursuant to its ability to object in good faith to a sale or to impose a transfer fee. Chevron certainly has that power pursuant to its ability unilaterally to increase the wholesale price of the gasoline to its dealers. Indeed, the district court specifically discussed Chevron's ability to charge more for its gasoline and thereby to capture the premium: "Defendant's expert fails to explain why the oil company would not increase the wholesale price to simply offset the

decrease in rent. . . . Neither Defendants nor Defendants' expert have offered any reason why this is not a feasible, and even likely, result."

I recognize that the district court also stated that "the Act . . . allows incumbent dealers to capture the value of the decreased rent in the form of a premium," but the court made the statement to show why the Act was not likely to achieve its purpose of lowering retail gasoline prices rather than to justify the application of the "substantially advances a legitimate state interest" test. The question under *Richardson* is not whether the terms of the Act themselves allow – *i.e.*, do not prohibit – capture of the premium; rather, the question is whether the Act creates a situation where we know the premium will, in fact, be captured. As the district court noted, the "feasible, even likely, result" is that Chevron will take that premium for itself in the form of higher wholesale prices charged to its dealers.

III

I fear that under the majority opinion virtually all rent control laws in the Ninth Circuit are now subject to the "substantially advances a legitimate state interest" test, and that this test may invalidate many of these laws. I will not undertake an extended analysis of the economic and social effects of rent control laws. Suffice it to say that the virtually unanimous opinion of economists is that, except in unusual and short-lived circumstances, they often do not achieve their stated purposes. They result in the creation of large and unwieldy bureaucracies. They do not subsidize the truly needy – the

homeless and those in public housing; rather, they subsidize those already able to pay for their own housing, including many who can easily pay an open market price. They interfere with the normal play of free market forces, thereby creating incentives that result in reduced supplies of housing, reduced maintenance and repairs on existing housing, increased housing code violations, and increased transportation inefficiencies when tenants change schools or jobs but remain in rent-controlled housing.

The question before the judiciary is not the advisability of rent control laws but rather their constitutionality. Ever since its retreat from economic substantive due process at the end of the 1930s, the Supreme Court has essentially left it to the other branches of government to decide, in their political wisdom, whether to adopt rent and price controls. The Supreme Court's hints in *Pennell* and *Yee* may signal a willingness to rethink this long-ago retreat, but at this point the Court has not yet done so.

I am not sure whether, in *Richardson*, we properly interpreted the Court's hints in *Yee* in concluding that the "substantially advances a legitimate state interest" test used in zoning and land use regulation cases should have been applied to the rent control ordinance in that case. I am inclined to think that we did not. I am sure, however, that the majority in this case extends *Richardson* beyond current law.

IV

It is not clear that Hawaii's Act 257 will result in the capture of a premium representing a one-time wealth

transfer to dealers currently leasing stations from Chevron. Thus, even assuming that *Richardson* is good law, Act 257 should not be analyzed under the "substantially advances a legitimate state interest" test. Rather, Act 257 should be analyzed under the reasonableness test applicable to ordinary rent and price control laws. While I agree with the majority that the summary judgment granted to Chevron should be reversed, I disagree with the majority about the district court's task on remand. In my view, the district court should apply the reasonableness test applied – until today – to ordinary rent and price control laws.

IN THE UNITED STATES DISTRICT COURT

FOR THE DISTRICT OF HAWAII

CHEVRON U.S.A. INC., Plaintiff, vs. BENJAMIN J. CAYETANO, ET AL., Defendants.	CIV. NO. 97-0933 ACK

ORDER RE: MOTIONS FOR SUMMARY JUDGMENT

SYNOPSIS

(Filed Nov. 10, 1998)

The Court is mindful of the strongly felt concerns of the legislature that Hawaii's consumers are paying too much for gasoline. However, the Court finds that Act 257 as crafted fails to substantially further this legitimate state interest, and therefore effects an unconstitutional taking.[1] Section 3(c) of Act 257, which limits rents that an oil company may charge its lessee dealers, fails to benefit dealers and consumers for two principal reasons. First, similar to the condominium tenants under the rent control ordinance declared unconstitutional in *Richardson v. City and County of Honolulu*, incumbent dealers are able to

[1] The Court notes the State of Hawaii has now pursued other means to rectify these concerns by filing suit against gasoline wholesalers in Hawaii, alleging, inter alia, they have engaged in price fixing.

capture the value of reduced rent in the form of a premium upon sale of their leaseholds, and consequently, incoming lessee dealers are not benefitted by the Act. 124 F.3d 1150 (9th Cir. 1997), *cert. denied*, 1998 WL 313049 (Oct. 5, 1998), *and cert. denied*, 1998 WL 407121 (Oct. 5, 1998).[2] Second, since oil companies can offset rent reductions by increasing wholesale gasoline prices, they can unilaterally negate any benefit to be realized by dealers and consumers.

BACKGROUND

On June 21, 1997, the Hawaii Legislature, prompted by concerns regarding the relatively high price of gasoline charged to Hawaii consumers, enacted Act 257 of the Hawaii Revised Statutes. Act 257, inter alia, implements restrictions on gasoline manufacturers and jobbers in dealing with their retail dealers. Specifically, Section 3(c) of Act 257 ("the Act") restricts the amount of lease rent an oil company may charge a lessee dealer for use of a service station.

In response to the enactment of the Act, Plaintiff Chevron brought suit against Defendants Benjamin J. Cayetano, Governor of the State of Hawaii, and Margery S. Bronster, Attorney General of the State of Hawaii, challenging Section 3 of the Act as effecting an unconstitutional taking of Chevron's property in violation of the Fifth and Fourteenth Amendments of the United

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[2] The Court notes that Act 257 was enacted before the Ninth Circuit Court issued its decision in *Richardson*.

States Constitution. Section 3 of the Act reads, in pertinent part:

> (c) All leases as part of a franchise as defined in section 486H-1, existing on August 1, 1997, or entered into thereafter, shall be construed in conformity with the following:
>
> (1) Such renewal [of the lessee-dealer's leasehold] shall not be scheduled more frequently than once every three years; and
>
> (2) Upon renewal [of the leasehold], the lease rent payable shall not exceed fifteen percent of the gross sales, except for gasoline, which shall not exceed fifteen percent of the gross profit of product, excluding all related taxes by the dealer operated retail service station as defined in section 486H-1 and 486H-plus, in the case of a retail service station at a location where the manufacturer or jobber is the lessee and not the owner of the ground lease, a percentage increase equal to any increase which the manufacturer or jobber is required to pay the lessor under the ground lease for the service station. For the purpose of this subsection, "gross amount" means all monetary earnings of the dealer from a dealer operated retail service station after all applicable taxes, excluding income taxes, are paid. The provisions of this subsection shall not apply to any existing contracts that may be in conflict with its provisions.
>
> (d) Nothing in this section shall prohibit a dealer from selling a retail service station in any manner.

Haw. Rev. Stat. § 486H-10.4 (1997).

On January 28, 1998, Plaintiff filed a motion for partial summary judgment on its Second Claim for Relief. On July 30, 1998, Defendants responded and filed a cross motion for summary judgment on all claims in Plaintiff's complaint. On August 19, 1998, and August 28, 1998, Plaintiff and Defendants each filed their respective replies. The Court heard oral arguments on September 8, 1998. Both parties agreed that this case should be decided one way or the other on summary judgment.

SUMMARY JUDGMENT STANDARD

Summary judgment shall be granted where there is no genuine issue of material fact and the moving party is entitled to judgment as a matter of law. Fed. R. Civ. P. 56(c). One of the principal purposes of the summary judgment procedure is to identify and dispose of factually unsupported claims and defenses. *See Celotex Corp. v. Catrett*, 477 U.S. 317, 323 (1986).

The United States Supreme Court has declared that summary judgment must be granted against a party who fails to demonstrate facts to establish an element essential to his case where that party will bear the burden of proof of that essential element at trial. *See Celotex*, 477 U.S. at 322. "If the party moving for summary judgment meets its initial burden of identifying for the court the portions of the materials on file that it believes demonstrate the absence of any genuine issue of material fact [citations omitted], the nonmoving party may not rely on the mere allegations in the pleadings in order to preclude summary judgment." *T.W. Elec. Serv. v. Pacific Elec. Contractors Ass'n*, 809 F.2d 626, 630 (9th Cir. 1987).

Rather, Rule 56(e) requires that the nonmoving party set forth, by affidavit or as otherwise provided in Rule 56, specific facts showing that there is a genuine issue for trial. *See T.W. Elec. Serv.*, 809 F.2d at 630. At least some "significant probative evidence tending to support the complaint" must be produced. *Id.* Legal memoranda and oral argument are not evidence and do not create issues of fact capable of defeating an otherwise valid motion for summary judgment. *See British Airways Bd. v. Boeing Co.*, 585 F.2d 946, 952 (9th Cir. 1978).

The standard for a grant of summary judgment reflects the standard governing the grant of a directed verdict. *See Eisenberg v. Ins. Co. of North America*, 815 F.2d 1285, 1289 (9th Cir. 1987) (citing *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 250 (1986)). Thus, the question is whether "reasonable minds could differ as to the import of the evidence." *Anderson*, 477 U.S. at 250-51.

The Ninth Circuit has established that "[n]o longer can it be argued that any disagreement about a material issue of fact precludes the use of summary judgment." *California Architectural Bldg. Products, Inc. v. Franciscan Ceramics, Inc.*, 818 F.2d 1466, 1468 (9th Cir. 1987). Moreover, the United States Supreme Court has stated that "[w]hen the moving party has carried its burden under Rule 56(c), its opponent must do more than simply show that there is some metaphysical doubt as to the material facts." *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574, 586 (1986).

Indeed, "if the factual context makes the nonmoving party's claim *implausible*, that party must come forward with more persuasive evidence than would otherwise be

necessary to show that there is a genuine issue for trial." *Franciscan Ceramics*, 818 F.2d at 1468 (emphasis in original) (citing *Matsushita*, 475 U.S. at 587). Of course, all evidence and inferences to be drawn therefrom must be construed in the light most favorable to the nonmoving party. *See T.W. Elec. Serv.*, 809 F.2d at 630-31.

DISCUSSION

I. Ripeness

Initially, the Court must determine whether Plaintiff's takings claim is ripe. As the Ninth Circuit noted in *Richardson*, there are two hurdles to a regulatory taking claim brought in federal court:

> The first hurdle, . . . that the plaintiff obtain a final decision regarding the application of the regulation to the property at issue from the entity charged with implementing the regulation . . . does not apply to facial regulatory takings claims. . . . The first hurdle thus does not apply to [Plaintiff's] argument.
>
> The second hurdle stems from the Fifth Amendment's proviso that only takings without 'just compensation' infringe that Amendment; 'if a State provides adequate procedure for seeking just compensation, the property owner cannot claim a violation of the Just Compensation clause until it has used the procedure and been denied just compensation.'

Richardson, 124 F.3d at 1165. Because Chevron's argument that Act 257 does not substantially advance a legitimate state interest does not depend upon the extent to which

Chevron is compensated, its facial regulatory taking claim is ripe.

II. The Takings Clause

The Takings Clause of the Fifth Amendment of the United States Constitution states: "[N]or shall private property be taken for public use, without just compensation." U.S. Const., Amend. V. The United States Supreme Court has consistently distinguished "physical takings" from "regulatory takings." A physical taking occurs when a governmental entity authorizes a permanent physical occupation of real property. *See Yee v. City of Escondido*, 503 U.S. 519, 535 (1992). By contrast, the regulatory taking issue typically arises when a government regulation, such as a zoning regulation or a rent control law, affects a property owner's ability to use his land. *See id.* In the words of Justice Holmes, "while property may be regulated to a certain extent, if regulation goes too far it will be recognized as a taking." *Pennsylvania Coal Co. v. Mahon*, 260 U.S. 393, 415 (1922).

The Court notes that it is well established that legislative acts come to the Court with a presumption of constitutionality, *see Concrete Pipe & Products of California, Inc. v. Construction Laborers Pension Trust*, 508 U.S. 602, 637 (1993); *Duke Power Co. v. Carolina Environmental Study Group, Inc.*, 438 U.S. 59, 83-84 (1978); *Usery v. Turner Elkhorn Mining Co.*, 428 U.S. 1, 15 (1976), and therefore Plaintiff faces an uphill battle in its challenge to Act 257.

A. Facial Challenge

When a party alleges that an act of the legislature effects an unconstitutional taking, they may bring either a "facial" challenge or an "as applied" challenge. The Supreme Court has repeatedly held that a land use regulation will be found to effect a taking if it does not substantially advance a legitimate state interest or denies the landowner economically viable use of his land. *See Dolan v. City of Tigard*, 512 U.S. 374, 385 (1994); *see also, Lucas v. South Carolina Coastal Council*, 505 U.S. 1003, 1016 (1992); *Keystone Bituminous Coal Assn. v. DeBenedictis*, 480 U.S. 470, 485 (1987); *Agins v. Tiburon*, 447 U.S. 255, 260 (1980).

The relevant inquiry in a facial challenge is whether "mere enactment" of the challenged regulation effects a taking. *See Agins*, 447 U.S. at 260. For example, in *Agins*, the city of Tiburon adopted zoning ordinances that limited development of appellant's five-acre lot to a maximum of five single-family residences. Appellants brought suit against the city, alleging that the ordinances prohibited all development of their land and thus effected a taking of their property. The California Supreme Court rejected appellants' request for a declaration that the zoning ordinances were facially unconstitutional, holding that the terms of the challenged ordinances allowed the appellants to construct between one and five residences on their property. *See id.* at 262.

The Supreme Court granted certiorari, and held that the ordinances substantially advanced legitimate governmental goals. *See id.* at 261. In reaching this decision, the Court considered the benefits of the ordinances as well as

any diminution in market value that the appellants might suffer. The Court also considered appellants' allegations that they wished to develop the land for residential purposes, that the land was the most expensive suburban property in the State, and that the best possible use of the land was residential, and held that although the ordinances limited development, they neither prevented the best use of appellants' land or extinguished a fundamental attribute of ownership. The Court further held that the general plan advanced a legitimate state interest – protection from urbanization. Finally, the Court noted that the ordinance did not impose a burden solely on one landowner, it affected development generally, and therefore the public did not benefit at the expense of a few. *See id.*

Similarly, in *Richardson,* the plaintiff brought a facial challenge to a rent control ordinance that placed a cap on renegotiated ground rent that could be charged by the owner of the land under condominium units. *See* 124 F.3d at 1163. The Ninth Circuit first considered the typical condominium ground lease scheme, noting that since the land underneath condominiums is ordinarily owned by someone other than the condominium owner-occupant, the condominium owner must lease the ground underneath the unit for long periods. The court went on to find that although these leases are initially fixed for a term of years, the rent is subject to renegotiation which typically is based on a percentage of the fair market value of the land appurtenant to the unit, exclusive of improvements, as of the date of the renegotiation. Finally, the court recognized that the ordinance at issue was enacted because the rapid rise in Hawaiian land prices often resulted in renegotiated rents several hundred times

greater than the initial fixed rent. Nonetheless, the Ninth Circuit declared the ordinance facially invalid, holding that the absence of a mechanism to prevent owner-occupants from capturing a premium upon the resale of their unit meant that the ordinance would not substantially further its goal of creating affordable housing. *See id.* at 1166.

In the instant case, Plaintiff brings a facial challenge to Act 257, arguing that the rent cap provision of the Act effects an unconstitutional taking because it fails to substantially advance a legitimate state interest and it leaves Plaintiff with no economically viable use of its land.

B. Applicable Standard in Regulatory Takings Analysis

Defendants argue that Act 257 does not effect a taking, and is therefore constitutional. Moreover, Defendants claim that Plaintiff is applying the wrong standard in evaluating the state interest portion of the takings analysis.

According to Defendants, in order for the Act to pass constitutional muster, it is not necessary that the Act *actually* further the state interest involved, but merely that the Legislature rationally could have believed that the Act would do so. In support of this argument, Defendants cite *Hawaii Housing Authority v. Midkiff*, 467 U.S. 229 (1984). However, *Midkiff* dealt with a physical taking, rather than a regulatqory taking, and is thus distinguishable from the present case. *See id.* at 233. In the physical taking context, the government exercises its eminent domain power to take private property for "public use."

Furthermore, once the government decides to physically take property, it must provide just compensation to the person from whom the property was taken. At issue in *Midkiff* was the propriety of the purported "public use" advanced by the government to justify the taking. *See id.* at 235. The *Midkiff* Court held that the only requirement in a physical taking, since the taking is fully compensated, is that the legislature "rationally could have believed" the taking would serve the purported "public use." *See id.* at 242.

By contrast, the present case deals not with a physical taking, but with whether there has been a *regulatory* taking, an inquiry which requires a different analysis. In the regulatory taking context, the inquiry is not whether property has been taken for a public use, but rather, whether or not a government regulation substantially advances a legitimate state interest. As clarified in *Hall v. City of Santa Barbara*, 833 F.2d 1270 (9th Cir. 1986), *cert. denied*, 485 U.S. 940 (1988):

> In [*Midkiff*], the Court explored the meaning of the public use requirement in the Fifth Amendment's eminent domain clause. . . . The Court in *Midkiff* did not address the somewhat different articulation of the standard applicable in cases where there was no deliberate exercise of the eminent domain power. For example, it did not mention *Agins v. City of Tiburon* . . . where it had noted that "the application of a general zoning law to a particular property effects a taking if the ordinance does not substantially advance legitimate state interests. . . . " The *Midkiff* Court left open the possibility that less deference would be afforded where government does not intend to effect a taking than where it does. . . .

> It makes considerable sense to give greater deference to the legislature where it deliberately resorts to its eminent domain power than where it may have stumbled into exercising it through actions that incidentally result in a taking.

Id. at 1280. The United States Supreme Court echoed this viewpoint in *Nollan v. California Coastal Comm'n*, 483 U.S. 825, 835 (1987), when it stated:

> We have required that the regulation [in the takings context] "substantially advance" the "legitimate state interest" sought to be achieved, not that "the state could rationally have decided" that the measure adopted might achieve the State's objective.

Id. Finally, the Ninth Circuit's opinion in *Richardson*, a case discussed by both parties in the instant case, further clarified this concept:

> The language used throughout *Midkiff* indicates that deference to the legislative body's public use determination is required when the taking is fully compensated. . . . [W]e believe that Nollan-Lucas-Dolan trio does not signal a change from this longstanding rule of deference because we see nothing inconsistent in applying heightened scrutiny when the taking is uncompensated, and a more deferential standard when the taking is fully compensated.

124 F.3d at 1158. Thus, the Court finds that, in order to determine whether the Act effects a taking, the appropriate inquiry is whether the Act substantially advances a legitimate state interest, not merely whether the legislature rationally believed it would do so.

C. Advancement of a Legitimate State Interest

The United States Supreme Court has not elaborated on the standards for determining what constitutes a "legitimate state interest" or what type of connection between a regulation and the state interest satisfies the requirement that the former "substantially advance" the latter. *Nollan*, 483 U.S. at 834. However, the Court has made clear that a broad range of governmental purposes and regulations satisfies these requirements. *See id.*

1. State Interests to be Advanced

Before determining whether a legitimate state interest is advanced by the Act, it is necessary to ascertain the specific state interests involved. Plaintiff argues that the purpose of Act 257 is to provide protection for service station lessee dealers. Defendants, however, assert that Act 257 is designed to protect consumers from the harmful effects of the highly concentrated petroleum market in Hawaii.

Defendants' contention is not without merit, for on its face, Act 257 appears to be directed toward the protection of consumers. Section 1 of Act 257 reads, in pertinent part:

> (1) The petroleum industry is an essential element of Hawaii's economy and is therefore of vital importance to the health and welfare of all people in the State of Hawaii; . . .
>
> (4) Because Hawaii is a physically small and geographically remote economy, certain of its markets tend to be concentrated. Market concentration is a function of the number of firms

> in the market and their respective market shares. In a highly concentrated market, market prices tend to rise above competitive levels. *Market prices persistently above competitive levels are harmful to consumers and the public.* Barriers to competition tend to cause supracompetitive prices to persist; and
>
> (5) The markets for oil and oil products in Hawaii are highly concentrated markets.

Haw. Rev. Stat. § 257 (1997) (emphasis added).

However, a closer examination of Act 257, specifically its legislative history, reveals another interest, namely "to provide certain protection for dealer operated retail service stations." Conf. Comm. Rep. 38, H.B. No. 1451 (1997).

While these two interests appear to be distinct from one another, they do not conflict. A thorough analysis of Defendants' argument reveals that in order to further the state's interest of protecting consumers, it is first necessary to help lessee dealers, whose viability might lead to a less concentrated – and thus more consumer friendly – market. Thus, the Court finds that while the legislature was mindful of the need to protect lessee dealers, this consideration was essentially a step toward the ultimate goal of reducing gasoline prices for Hawaii's consumers.[3]

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[3] Even if the ultimate goal of the legislature was to help lessee dealers, Act 257 would still fail to substantially advance its purpose. As discussed below, incumbent lessee dealers can capture the value of the reduced rent in the form of a premium, thereby depriving incoming lessee dealers of the benefit of the rent cap. Similarly, oil companies can offset any decrease in rent

Having ascertained the state interests to be advanced by Act 257, the Court's next task is to determine whether or not these interests are substantially advanced.

2. Advancement of State Interests

In support of its motion for partial summary judgment, Plaintiff argues that the Act fails to substantially advance a legitimate state interest. The Court agrees with Plaintiff, on two principal grounds.

a. New Dealers are Not Protected Because Incumbent Dealers Can Capture the Value of the Reduced Rent in the Form of a Premium

Defendants argue that the savings realized from reduced rent under the Act will lead to the continued business viability of independent dealers, keeping them in the market. They further argue that this, in turn, will lead to a less concentrated market, giving consumers more choices and lowering retail prices by way of increased competition.

Plaintiff argues, and the Court agrees, that the rent cap provision of the Act fails to protect new lessee dealers because it allows incumbent dealers to capture the value of the decreased rent in the form of a premium. The existence of the rent cap makes an independent

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with an increase in wholesale prices, and thereby eliminate the benefit to the lessee dealer.

dealer's leasehold interest in a service station more valuable, and this added value becomes especially significant when an incumbent dealer undertakes to sell his interest. *See* Stipulation of Facts, ¶¶ 34, 35 at 10-11. Since the Act does not prohibit an incumbent dealer from selling his or her service station lease, the rent cap provision enables these dealers to sell their stations at a premium. *See id.* at ¶¶ 28, 29. Because the dealer to whom the interest is transferred will be required to pay the premium, the overall expense incurred by the incoming lessee dealer remains the same, and as a result, there are no savings to pass along to consumers.

In support of this argument, the Court finds *Richardson*, 124 F.3d at 1150, controlling. In *Richardson*, the Ninth Circuit addressed a rent control ordinance that placed a cap on renegotiated ground rent that could be charged by the owner of the land under condominium units. The ordinance was enacted for the purpose of providing affordable housing to owner-occupants. *Id.* at 1165. The trustees of the Bishop Estate, owner of the fee simple title to the land underneath condominiums that were affected by the ordinance, brought an action contesting the constitutionality of the ordinance. Since the owner-occupant of a condominium was free to transfer his or her "rent-controlled" leasehold interest, the owner-occupant was able to capture the value of that rent cap in the form of a premium. *Id.* at 1164. The ordinance was challenged by the plaintiff as an unconstitutional taking.

The Ninth Circuit affirmed the district court's finding that the ordinance effected a regulatory taking. According to the Ninth Circuit, since the ordinance did not provide a mechanism to prevent the lessees from capturing the

premium, the state interest in providing affordable housing was not substantially advanced, as ultimately the price of housing would remain the same. *Id.* at 1166.

Like *Richardson*, the possibility of a sales premium in the case at bar prevents the state interests from being substantially advanced. Act 257 fails to provide a mechanism to prevent dealers from capturing a premium. Indeed, cases like *Yee* and *Hall* suggest that it is inappropriate, if not unconstitutional, to fail to provide a mechanism in rent control legislation to preclude the capture of a premium. *See Yee*, 503 U.S. at 527-31; *Hall*, 833 F.2d at 1279-80. Moreover, the potential for a premium in the present case is even more compelling than that in *Richardson*, since it is likely that a lessee dealer will find it easier to part with his or her business, than would a homeowner with his or her home. Presumably, a homeowner wishes to remain where he or she lives, whereas a businessperson is likely to view maximization of profits as the ultimate business goal. Thus, because an independent dealer can unilaterally negate any benefit a transferee might receive from the Act, it fails to substantially advance the state's interest in protecting new dealers.

Defendants argue that *Richardson* is distinguishable from the present case because the purpose of Ordinance 91-96, which was at issue in *Richardson*, and the purpose of Act 257 are distinct. The primary goal of Ordinance 91-96 was to provide affordable housing for owner-occupants of condominiums subject to ground leases. The "Findings and Purpose" section of Ordinance 91-96 states, in relevant part:

The council finds that:

* * *

(3) . . . owner-occupants of condominium[s] . . . were not informed . . . of lease rent renegotiation . . . terms . . . of the lease, [which are] established unilaterally by the lessors. . . . ;

(5) . . . Unless controlled, the renegotiated lease rents may be unaffordable to many owner-occupants of leased condominium housing units . . . ;

(6) . . . owner-occupants may have no recourse but to terminate their leases or sell . . . and seek housing elsewhere . . . ;

(7)(E) Residential leaseholds have also undesirable social effects . . . [because] as the lessee advances in age, [the] lessee's income potential declines, . . . causing the lessee to give up the lease . . . ;

* * *

The council further finds and declares:

* * *

(3) . . . lease rent increases of 1,000 percent would make home ownership unaffordable to a substantial number of owner-occupants of residential condominiums. . . .

Honolulu City and County, Haw. Ordinance 91-96 § 1. Defendants argue that unlike the ordinance at issue in *Richardson*, which was enacted to provide affordable housing, the purpose of Act 257 is not to provide affordable gas station purchases, but rather, to benefit consumers. Thus, even if transferee dealers are negatively

impacted by a premium, according to Defendants, incumbent dealers will still benefit from the rent cap and will thus pass along their savings to consumers, who will thereby benefit as well. The Court disagrees.

First of all, in *Richardson*, although the owner-occupants who retained their condominiums would clearly receive a direct benefit from the rent cap each month, the Ninth Circuit nonetheless declared the Ordinance unconstitutional because it failed to prevent owners of condominiums from capturing a premium upon the sale of their units, thereby depriving the purchasers of any benefit from the rent cap and resulting in the price of housing ultimately remaining the same. Moreover, while it is possible that some lessee dealers may benefit from the Act's rent cap in the form of lower overall costs, there is no reason to conclude that such dealers will react to this savings by lowering their retail prices. Dealers may instead elect to maintain a higher profit margin, since the Act includes no mechanism to prevent lessee dealers from simply keeping their prices the same and retaining the profit from the reduced rent on a month-to-month basis. Nothing has been presented to the contrary.[4]

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[4] The parties agree that under current conditions, Act 257's rent cap will only affect 11 of Chevron's 64 lessee dealer stations in Hawaii. *See* Stipulation of Facts, ¶ 6 at 4. Thus, less than 20 percent of Chevron's stations will be impacted by the rent cap. No evidence has been presented as to how the Act affects the remaining non-Chevron stations.

The Court nonetheless finds that Act 257 fails to substantially advance a legitimate state interest, because it is probable that consumers will not benefit from the rent cap as applied to these remaining stations. First, it is possible that, like

b. Incumbent Dealers Are Not Protected Because Rent Reductions Can Be Offset By Wholesale Price Increases

Defendants also argue that since the rent cap provision of the Act helps incumbent dealers to maintain their viability, the market will be less concentrated, giving the consumer more choices. They go on to argue that this lowered concentration means more competition and thus lower retail prices. The Court finds it unlikely that the Act will lead to such a result.

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53 of Chevron's lessee dealer stations, the Act will not impact these other stations at all. If this is the case, then the Act will certainly not benefit consumers, since prices at these stations will remain unchanged. Second, even if the Act were to impact these stations, there is no mechanism to prevent incumbent dealers from capturing a premium upon the sale of their stations, as discussed at length above. Therefore, under either scenario, Act 257 does not substantially advance the state's interest in benefitting consumers. Furthermore, even in the absence of a captured premium, the Act still fails to advance its purpose. As discussed infra, and as acknowledged by the government, Chevron can merely offset the decreased rent by increasing their gasoline prices, thereby negating any benefit to be achieved by the Act. The Court finds no reason why other oil companies would not act likewise. In light of these considerations, it is highly unlikely that the minimal number of dealers who might be benefitted by the Act would make a competitive impact if they were to lower their prices.

Finally, the fact that Act 257 allows Chevron to charge approximately $1.1 million more than it would otherwise have charged under its own rental program further demonstrates the Act's ineffectiveness in its purpose of protecting consumers. *See* Stipulation of Facts, Table 1.

There is no dispute that Plaintiff receives income from dealers in the form of both rent and fuel sales. Importantly, the Act does not place any limitation on the price of fuel sales. Thus, an oil company can raise fuel prices to compensate for the reduction in rent, and as a result, dealers will not receive any benefit from the rent cap.[5]

Defendants argue that although oil companies are free to raise fuel prices to offset any reduction in rent, they will not do so.[6] Defendants' expert states that an

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[5] In fact, Defendants have acknowledged this possibility in their brief. Defendants' brief reads, in relevant part:

> In contrast, Chevron's lessee dealer gas stations provide Chevron with two sources of revenue. Chevron uses both to pay the expenses it incurs in leasing the service stations. The first source is the contract rent that is subject to Act 257. The second source of revenue is from the sale of Chevron gasoline to lessee dealers which lessees are required to purchase from Chevron under the supply agreement Chevron requires of the dealer lessees. The revenue which Chevron receives from its gasoline sales is substantially greater than the contract rent. Act 257 does not impose a cap on the amount Chevron may charge for gasoline and other products it sells its lessee dealers. Therefore, Act 257 does not deprive Chevron of the ability to increase the DTW price, Chevron's primary revenue stream from its lessee stations, in the event of an increase in costs.

See Def.'s Mot. for Summ.J., p. 28-29 (citations omitted).

[6] Plaintiff's expert disagrees. It is evident from Plaintiff's expert's declaration that this can and will occur in response to a reduction in rent. *See* Declaration of John R. Umbeck, p. 3, ¶ 5(b); p. 8, ¶ 16; p. 11, ¶ 21. According to Plaintiff's expert, Act 257 will (1) penalize Chevron and its lessee dealers, reducing

increase in wholesale fuel prices by an oil company would lead the dealer to increase his retail fuel prices. This increased retail price, according to Defendants, would result in a decreased volume of fuel sales, which would ultimately hurt the oil company. However, Defendants' expert fails to explain why the oil company would not increase the wholesale price to simply offset the decrease in rent.[7] Indeed, there is no economic reason why a shift from paying a certain sum as "rent" to paying that same sum as "fuel price" would lead a dealer to react by raising his gas prices when his overall costs remain the same. By doing so, he would be acting against his own interest, running the risk of decreased sales because of the increased prices. Instead, it is likely that if a dealer's overall costs remain the same, he will choose to remain competitive by keeping his retail prices the same. Because oil companies can simply raise their wholesale prices to the same extent that rent decreases, the dealer is likely to be unaffected by the rent cap, and gas prices will

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their viability in Hawaii; (2) penalize consumers because it can be expected to lead to higher retail gasoline prices; (3) not benefit future lessee dealers because dealers can capture the value of the rent cap in the form of a premium; and (4) not permit Chevron to earn a reasonable return on its investments. *See id.* at p. 3, ¶ 5. By contrast, Defendants' expert claims that Act 257 will (1) benefit consumers by decreasing the concentration in the gasoline market; (2) benefit both incumbent and transferee dealers; and (3) provide Chevron a reasonable return on its investment. *See* Declaration of Keith B. Leffler, p. 4-5, ¶ 7.

[7] Neither Defendants nor Defendants' expert have offered any reason why this is not a feasible, and even likely, result.

remain unchanged.[8] Consequently, the Act's purpose of protecting the dealer – and thereby protecting the consumer – would not be met.

Since Chevron's Dealer Supply Contract allows a lessee dealer to purchase fuel from suppliers other than Chevron, one might argue that if Chevron were to offset the decreased rent as described above, a dealer would simply "go elsewhere" to purchase his fuel. However, the Court finds that this is neither a feasible nor practical alternative. First, the terms of the Dealer Supply Contract state that a lessee dealer must purchase from Chevron all fuel that is necessary to fulfill customer demand for Chevron gasoline. Thus, even if a dealer wishes to discontinue Chevron gasoline and sell another brand, he may not do so if a demand for Chevron gasoline exists. Second, according to the Dealer Lease, if a lessee dealer chooses to market and sell other gasoline, he must install his own pumps and tanks, and he must make it clear to consumers that the fuel contained therein is not Chevron fuel. As stipulated to by the parties, there are only two local refinery sources: Chevron, which supplies sixty percent of the gasoline produced or refined in Hawaii, and Tesoro, which supplies forty percent. *See* Stipulation of

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[8] Although Defendants might argue that an oil company may not be able to accurately assess the amount of increase in wholesale price needed to offset the decrease in rental income, the parties agree that, where an economic benefit or loss is difficult to quantify, on average, the participants will estimate accurately. *See Declaration of Keith B. Leffler,* p. 11-12, ¶ 16 (discussing accuracy of estimating value of rent cap in order to calculate premium); *Declaration of John R. Umbeck,* p. 12, ¶ 22; p. 13, ¶ 24 (discussing estimation of rent cap value).

Facts, ¶ 38 at 11. Therefore, if a dealer chose to obtain gasoline from another source, it would be cost-prohibitive without some sort of "concerted action," since importing gasoline requires purchasing a large quantity and chartering a vessel to transport it. Because this is not a realistic alternative, the Court finds that a lessee dealer's mere ability to purchase fuel from other sources does not negate the probability that an oil company such as Chevron and Tesoro could be successful in defeating the rent cap by offsetting decreased rent with increased fuel prices.

For all of the reasons outlined above, the Court finds that Section 3(c) of Act 257 fails to substantially advance a legitimate state interest, and as such, effects an unconstitutional taking in violation of the Fifth and Fourteenth Amendments of the Constitution.[9],[10]

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[9] While the Court recognizes that Plaintiff brings a facial challenge to Act 257, the Court notes that Act 257 has been in operation since June of 1997, and yet the state claims in its lawsuit filed on October 1, 1998, which alleges antitrust violations, that the price of gasoline for consumers is an average of $.30 per gallon higher than prices on the mainland. This further illustrates the ineffectiveness of Act 257 in its purpose of benefitting consumers. However, the Court has not considered the foregoing in reaching its decision.

[10] Plaintiff also challenges the Act as effecting an unconstitutional taking on two alternate grounds: (1) that it leaves them with no economically viable use of their land, and (2) that the Act fails to provide for individualized consideration. Because the Court finds that the Act fails to substantially advance a legitimate state interest, it need not address these alternate arguments.

III. Other Claims

Plaintiff moved for partial summary judgment only on its Second Claim for Relief, while Defendants moved for summary judgment on all claims. Defendants failed to satisfy their burden on Plaintiff's First, Third, Fourth, Fifth, Sixth, and Seventh Claims for Relief, because they did not present any evidence which demonstrates that there is no genuine issue of material fact as to those claims. This is particularly true with regard to Plaintiff's First Claim for Relief (Deprivation of Constitutional Rights in Violation of 42 U.S.C. § 1983) and Fifth Claim for Relief (impermissible taking in violation of the Hawaii Constitution), inasmuch as the Court finds that Act 257 effects an unconstitutional taking. Accordingly, summary judgment on those claims is DENIED.

In their brief, Defendants represented that Plaintiff "announced" that it would not pursue its due process and equal protection claims. However, the Court does not find anything in the record which indicates that Plaintiff abandoned these claims. If it can be established that Plaintiff did make such a withdrawal, Defendants are entitled to summary judgment on the Third, Fourth, Sixth, and Seventh Claims for Relief.

CONCLUSION

The Court finds that Act 257 fails to substantially advance a legitimate state interest, and as such, effects an unconstitutional taking in violation of the Fifth and Fourteenth Amendments of the United States Constitution. For the foregoing reasons, the Court hereby GRANTS

Plaintiff's motion for summary judgment on its Second Claim for Relief.

IT IS SO ORDERED.

DATED: Honolulu, Hawaii, NOV 10 1998.

/s/ Alan C. Kay
Chief United States
District Judge

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

CHEVRON USA, INC., a Pennsylvania Corporation, Plaintiff-Appellee, v. BENJAMIN J. CAYETANO, Governor of the State of Hawaii; EARL I. ANZAI*, Attorney General of the State of Hawaii, Defendants-Appellants.	No. 99-15108 D.C. No. CV-97-00933-ACK ORDER (Filed Oct. 28, 2000)

Before: D.W. NELSON, BEEZER, and W. FLETCHER, Circuit Judges.

The majority of the panel has voted unanimously to deny the petition for rehearing. Judge W. Fletcher voted to grant the petition for rehearing. Judges D. Nelson and Beezer recommend denying the petition for rehearing en banc. Judge W. Fletcher votes to grant the petition for rehearing en banc.

The full court has been advised of the suggestion for rehearing en banc and no judge in active service has requested a vote to rehear the matter en banc. Fed. R. App. P. 35.

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* Earl I. Anzai is substituted for his predecessor Margery S. Bronster, as Attorney General for the State of Hawaii. Fed. R. App. P. 43(c)(2).

The petitions for rehearing and rehearing en banc are DENIED.

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

CHEVRON USA, INC., a Pennsylvania Corporation, Plaintiff-Appellee, v. BENJAMIN J. CAYETANO, Governor of the State of Hawaii; EARL I. ANZAI*, Attorney General of the State of Hawaii, Defendants-Appellants.	No. 99-15108 D.C. No. CV-97-00933-ACK AMENDED ORDER (Filed Oct. 31, 2000)

Before: D.W. NELSON, BEEZER, and W. FLETCHER, Circuit Judges.

The majority of the panel has voted to deny the petition for rehearing. Judge W. Fletcher voted to grant the petition for rehearing. Judges D. Nelson and Beezer recommended denying the petition for rehearing en banc. Judge W. Fletcher votes to grant the petition for rehearing en banc.

The full court has been advised of the suggestion for rehearing en banc and no judge in active service has requested a vote to rehear the matter en banc. Fed. R. App. P. 35.

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* Earl I. Anzai is substituted for his predecessor Margery S. Bronster, as Attorney General for the State of Hawaii. Fed. R. App. P. 43(c)(2).

The petitions for rehearing and rehearing en banc are DENIED.

STATUTE INVOLVED

Hawaii Revised Statutes, Chapter. 486H-10.4 (1997), provides in pertinent part:

(c) All leases as part of a franchise as defined in section 486H-1, existing on August 1, 1997, or entered into thereafter, shall be construed in conformity with the following:

(1) Such renewal shall not be scheduled more frequently than once every three years; and

(2) Upon renewal, the lease rent payable shall not exceed fifteen percent of the gross sales, except for gasoline, which shall not exceed fifteen percent of the gross profit of product, excluding 11 related taxes by the dealer operated retail service station as defined in section 486H-1 and [this section] plus, in the case of a retail service station at a location where the manufacturer or jobber is the lessee and not the owner of the ground lease, a percentage increase equal to any increase which the manufacturer or jobber is required to pay the lessor under the ground lease for the service station. For the purpose of this subsection, "gross amount" means all monetary earnings of the dealer from a dealer operated retail station after all applicable taxes, excluding income taxes, are paid. The provisions of this subsection shall not apply to any existing contracts that may be in conflict with its provisions.

(d) Nothing in this section shall prohibit a dealer from selling a retail service station in any manner.